81-1037

No.

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IN THE

Supreme Court of the United States

October Term, 1981

ISRAEL AND RALEY,

Petitioner,

v.

FUTURONICS CORPORATION,

Respondent.

On Petition for a Writ of Certiorari To The United States Court of Appeals for The Second Circuit

PETITION

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THE CASILLAS PRESS, INC.—1717 K Street N. W.—Washington, D. C.—223-1220

QUESTIONS PRESENTED

1. May a court, consistent with due process of law, impose a forfeiture of all right to compensation for successful litigation services authorized by a Bankruptcy Court Order on the basis that the payment of another attorney who contributed to such services with the client's consent is made a prohibited act by a restrictive construction of a penal provision?

2. Is an agreement to pay another attorney for contributed services rendered on behalf of a debtor-in-possession with the debtor's express consent prohibited by Bankruptcy Rule 219(d), if services are contributed by the other attorney and the payment therefor is at no charge to the estate?

3. After the performance of four years of services in litigation before a separate forum resulting in the creation of funds and benefits for creditors and shareholders alike, may a court, consistent with due process of law, deprive the attorney of both the right to and the amount of compensation specified in a retainer and fee agreement executed by the debtor-in-possession and a Bankruptcy Court Order which had not been reconsidered, vacated, modified, or set aside?

4. If a prohibited sharing of compensation has occurred, is the imposition of a disciplinary sanction against the compensation otherwise due for four years of dedicated and successfully completed litigation services a matter within the exclusive jurisdiction and sound discretion of the Bankruptcy Court depending upon the facts and equities in the particular case?

5. Is a special counsel subject to a penalty, if he had no adverse interest to the estate and has successfully completed all services in litigation before a separate forum, where his retention was authorized by the Bankruptcy Court on an application, prepared by the retained bankruptcy counsel on behalf of the debtor-in-possession, but the application did not disclose an employment agreement between the proposed special counsel and the bankruptcy counsel even though that employment

agreement was included in a retainer and fee agreement tendered by the proposed special counsel and which was fully executed by the bankruptcy counsel and by the debtor-in-possession?

PARTIES TO THE PROCEEDING

Petitioner, Israel and Raley, was a partnership of Fred Israel, Esq., and Charles E. Raley, Esq., located at 1015 18th Street, N.W., Washington, D.C.. Petitioner was a sole proprietorship of Mr. Israel, with Mr. Raley as his only law associate, when retained by Futuronics Corporation ("Futuronics") under an Order by Bankruptcy Judge Asa S. Herzog dated March 10, 1975, and a retainer and fee agreement executed on April 4, 1975. On January 1, 1976, Mr. Raley became Mr. Israel's partner. Petitioner's law practice was devoted to the prosecution of claims by contractors against the United States Government.

Futuronics was organized and exists under New York State law and has an office at 99 Powerhouse Road, Roslyn Heights, New York. Prior to January, 1975, Futuronics' business consisted of performing prime contracts for the United States' defense departments in two plants located in Freeport, Long Island, New York, and North Brookfield, Massachusetts. On January 3, 1975, Futuronics filed a Chapter IX Proceeding before the United States Bankruptcy Court for the Southern District of New York and became a debtor-continued-in-possession under Mr. Albert A. Blanck, its president and majority shareholder. Futuronics' twenty-one (21) contracts with the United States were terminated with $8,658,376 outstanding in unliquidated progress payments; its manufacturing facilities were sold at foreclosure proceedings; and it has since occupied offices at several locations.

Arutt, Nachamie, Banjamin, Lazar & Kirschner, P.C., formerly Arutt, Nachamie & Benjamin (the "Arutt firm"), 292 Madison Avenue, New York City, New York, was retained by Futuronics as bankruptcy counsel by an Order of Bankruptcy Judge Herzog on January 3, 1975, and was employed by Petitioner under the retainer and fee agreement executed by the Arutt firm on March 21, 1975, and by Mr. Blanck for Futuronics on April 4, 1975, providing for such execution "only after the Court has approved the retainer and fee agreement."

No appeal was entered by the Creditors' Committee or any individual creditor from the Opinion and Order of Bankruptcy Judge Lesser and, therefore, no creditor was a party to either of the appeals below.

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ISRAEL AND RALEY,

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FUTURONICS CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

OPINIONS BELOW

The opinion and order of the United States Bankruptcy Court by Lesser, J., is reported 5 C.R.R. 871. The opinion and order on appeal to the United States District Court by Duffy, J., is reported 5 B.R. 489. The majority opinion on appeal to the United States Court of Appeals for the Second Circuit by Meskill, J., and District Judge Sand, sitting by designation, and the dissenting opinion by Oakes, J., are reported 655 F.2d 463. The majority opinion denying petition for rehearing, with Circuit Judge Oakes adhering to his dissent, is not yet reported.

JURISDICTION

The opinion and order by the Bankruptcy Court was filed September 28, 1979. The opinion and order on appeal by Duffy, J., was filed June 26, 1980, and his judgment was filed August 29, 1980. The majority opinion by the panel for the Court of Appeals for the Second Circuit and the dissenting opinion by Oakes, J., were filed July 2, 1981. A timely petition for rehearing with a suggestion for rehearing in banc was denied September 4, 1981.

The case involves the majority decision of the panel for the United States Court of Appeals for the Second Circuit affirming the decision of a judge of the United States District Court affirming on appeal all findings of the United States Bankruptcy Court except the allowance of compensation to Petitioner, which finding was reversed by the substitution of a mandatory forfeiture of all compensation. This Court's jurisdiction is invoked under 28 U.S.C. Sec. 1254(1) and 11 U.S.C. Sec. 47(c) (1975).

CONSTITUTIONAL PROVISIONS, STATUTES AND COURT RULES

Constitution, Fifth Amendment.

No person shall . . . be deprived of . . . property, without due process of law . . .

United States Code, Title 28, Sec. 2075.

The Supreme Court shall have the power to prescribe . . .rules . . . under the Bankruptcy Act . . . . All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.

Bankruptcy Rules, *effective October 1, 1973:*
Rules 219, 11-2, and 11-31

[In a Chapter XI case] (a) A person seeking compensation . . . from the estate shall file . . . an application setting forth a detailed statement of . . . the services rendered and expenses incurred . . . the amounts requested . . . what payments have theretofore been made or promised . . . the source of the compensation . . . whether any compensation . . . has been shared and whether an agreement or understanding exists . . . for the sharing of compensation . . . and the particulars of any such sharing of compensation or agreement or understanding . . . .

(b) Every attorney for a [debtor], whether or not he applies for compensation shall file . . . at such other time as the court

may direct, a statement setting forth the compensation paid or promised . . . the source of the compensation . . . and whether the attorney has shared or agreed to share such compensation . . . the particulars of any such sharing or agreement to share . . . .

(c) The compensation allowable by the court . . . for services rendered in the administration of a bankrupt estate shall be reasonable, and . . . the court shall give due consideration to the nature, extent, and value of the services rendered as well as to the conservation of the estate and the interests of creditors

(d) Except as herein provided, a person rendering services in a [Chapter XI] case or in connection with such a case shall not in any form or guise share or agree to share the compensation paid or allowed him from the estate . . . with any other person . . . This rule does not prohibit . . . any attorney for a [debtor] . . . from sharing his compensation for services rendered with any other attorney contributing thereto. If a person violates this subdivision, the court may deny him compensation, may hold invalid any transaction subject to examination under Rule 220 to which he is a party, or may enter such other order as may be appropriate.

Bankruptcy Rules 215, 11-2, and 11-22.

[In a Chapter XI case] (a) No attorney . . . for the [debtor-in-possession] shall be employed except upon order of the court. The order shall be made only upon application of the [debtor-in-possession] stating . . . to the best of the applicant's knowledge all of the attorney's . . . connections with the [debtor] . . . and [the] respective attorneys . . . .

(b) If without disclosure any attorney . . . shall represent or hold . . . any interest adverse to the estate in any matter upon which he is so employed, the court may deny the allowance of any compensation to such attorney . . . and may also deny any allowance to the [debtor-in-possession] if it shall appear that he failed to make diligent inquiry into the connections of such attorney . . .

Bankruptcy Rule 11-24.

(a) . . . the court shall give the trustee or receiver, the debtor, and all creditors, including secured creditors, at least 10 days' notice by mail of . . . (7) the hearing on an application for allowances for compensation or reimbursement of expenses . . .

Bankruptcy Rules 801, 802, 803, and 11-62.

Unless a notice of appeal is filed with the bankruptcy judge within ten (10) days from the entry of the judgment or order . . . the judgment or order of the bankruptcy judge shall become final.

Bankruptcy Rules 911 and 11-63.

(a) . . . every written application must be so signed by . . . at least one attorney of record . . . or by the party making it . . . (b) Except as otherwise specifically provided by these Rules, papers filed in a [Chapter XI] case need not be verified.

Bankruptcy Rules 11-2(3), 11-23, 11-30, and 218.

"Receiver," "trustee," . . . means the . . . "debtor continued in possession" in the Chapter XI case. The court may authorize the . . . debtor in possession to conduct the business and manage the property of the debtor . . . . The debtor in possession shall . . . file a complete inventory of the property of the debtor . . . keep a record of receipts and the disposition of money and property received . . . make a written report to the court of the financial condition of the estate and the progress of its administration within a month after filing . . . a Chapter XI case and every month thereafter, and shall include a statement of the operation of the business for the preceding month . . .

STATEMENT OF THE CASE

This dispute arose when Mr. Blanck, Futuronics' president, founder, chairman of the Board, and majority shareholder, sought to disaffirm any obligation to compensate Petitioner and to thus retain such compensation for additional shareholders'

equity. Mr. Blanck asserted this position only after Petitioner had worked for four years, devoting 6,425 hours to the prosecution of the contract claims resulting in the successful recovery of funds and benefits allowing full payment for creditors and substantial equity for shareholders. Petitioner's services had been performed under a retainer and fee agreement executed by Mr. Blanck on April 4, 1975, and under a Bankruptcy Court Order of March 10, 1975, to which no objection had been filed and which had never been reconsidered, vacated, or reviewed. The retainer and fee agreement included a provision for Petitioner's hourly employment of the Arutt firm and was executed by Mr. Blanck without complying with its express requirement for prior Court approval, although the agreement was shown to the Creditors' Committee prior to its execution. During the case the Arutt firm reported to the Court its contribution of substantial services on the contract claims at no charge to Futuronics. The twice affirmed findings of the Bankruptcy Court establish that the funds and benefits resulted from the "competence, vigor, perseverence, and capacity for hard work amply demonstrated" by Petitioner in pursuing the contract claims and the "exhaustive documentation compiled" by Petitioner, its "mastery of the mass of material and the intricacies of Government procurement regulations," and "the matters revealed" during the trial. Where the creditors and shareholders had started out with nothing. Petitioner, with "help from the Arutt firm, created the fund. They are the collective goose that laid the golden egg." (App. 55, 69, 70-72). After the funds and benefits had been recovered, Mr. Blanck then objected to Petitioner's receipt of any compensation on the basis that Petitioner's employment of the Arutt firm and payment of that firm's three hourly bills with Mr. Blanck's agreement was not reported to the Bankruptcy Court until Petitioner had submitted its "Statement of Services Rendered" at the start of the proceedings for Petitioner's final compensation.

Five months after the Petitioner's completion of services, recovery of funds and benefits and "Statement of Services," the Opinion of successor Bankruptcy Judge Lesser initially set

aside the amount of and any right to compensation specified in the original Bankruptcy Court Order of March 10, 1975 (App. A-62-63, 73-75). Judge Lesser then concluded, that Petitioner should not have relied on the original Order and the executed retainer and fee agreement as fixing the compensation out of recovered funds and, therefore, Petitioner's "Statement of Services" was too late in that statements for allowances "from the estate" should have been submitted under Bankruptcy Rule 219(a) for the compensation paid during the case (App. A-53-54, 65-67). Further, although recognizing that "sharing of compensation for contributed services is not improper," here Petitioner's employment of and payment for the Arutt firm's contributed services in helping to create the funds, with Mr. Blanck's consent and at no charge to Futuronics, was deemed by Judge Lesser to be a prohibited act by construing the permitted sharing under Bankruptcy Rule 219(d) with "any other attorney contributing thereto" as limited to a retainer and services prior to the filing of a Chapter XI case (App. A-67-68). Judge Lesser allowed compensation for the Arutt firm's services as bankruptcy counsel, but ordered that firm to turn over to Futuronics the amount paid by Petitioner for "the more than 400 hours of professional time" by the Arutt firm on the contract claims (App. A-69-70). Then as a disciplinary sanction of Petitioner for "the Rule 219 problem" while avoiding an "unjustified windfall for the creditors and shareholders alike," Judge Lesser imposed a reduction of $190,000 to the total compensation of $1,040,000 he found otherwise due under Bankruptcy Rule 219(c) for the "concentrated effort" which precluded Petitioner, particularly Mr. Raley "from spending a significant amount of time on other litigation", Petitioner's "risk of not getting paid for a substantial number of the hours invested in the case", and the "favorable result" for all parties. Against the $850,000 result, he credited the total prior compensation of $218,380, for final compensation of $631,620 (App. A-69, 71-73). The creditors did not appeal.

The District Judge and the majority of the panel for the Second Circuit affirmed the Bankruptcy Court's findings, but

substituted a complete forfeiture of all compensation as being mandatory under *Arlan's Department Stores, Inc.*, 615 F.2d 925 (2nd Cir. 1979) and the language or "policy" of former Section 62(d) of the Bankruptcy Act, regardless of the discretionary terms of Bankruptcy Rule 219(d) (App. A-2, 17, 46, 48; C-80). The dissent below disagreed with the majority on both grounds (App. A-23-24).

Petitioner first met Mr. Blanck on January 24, 1975, and, although the Arutt firm had suggested another attorney, Mr. Blanck selected Petitioner to be the special counsel to prosecute contract claims and defend Government counterclaims and set-offs under an agreement that Petitioner would be compensated on a contingent basis depending upon Petitioner's ability to recover and make funds available on the terminated contracts (App. Aa-51-52; and Hearing Tr., 8/2/79, Blanck, pp. 13-16, Raley, pp. 13-17). Petitioner then met the Arutt firm on January 27, 1975, with Mr. Blanck, and upon questioning the capacity of Petitioner's two-man firm to handle the matters, the Arutt firm offered to render assistance on the contract claims to the extent of one-third of the required services for one-third of any compensation that might be received by Petitioner (Hearing Tr., Israel, pp. 174-176, 184-185, and 196).

Accordingly, Petitioner mailed to the Arutt firm an affidavit, requested by that firm, and a proposed retainer and fee agreement of January 30, 1975, which included a description of the one-third services and payment arrangement between the Petitioner and the Arutt firm and provided for execution by the Arutt firm and by Mr. Blanck "if acceptable" and "only after the Court has approved the retainer and fee agreement." (App. A-58, 62; D-81-83). The Arutt firm presented these terms to presiding Bankruptcy Judge Herzog, but the arrangement between the firms was not approved and, therefore, the retainer and fee agreement was not executed. (App. A-59).

Consequently, on March 3, 1975, Petitioner mailed to the Arutt firm the affidavit, with the one-third arrangement deleted, and the proposed retainer and fee agreement with a new

provision for the Petitioner's hourly employment of the Arutt firm, for execution by the Arutt firm and by Mr. Blanck "if acceptable" and "only after the Court has approved the retainer and fee agreement" (App. A-59; G-94-98). As provided in Bankruptcy Rule 911, the Arutt firm prepared and signed an application on behalf of Futuronics' for the authority to retain Petitioner and submitted the application to Judge Herzog with the said affidavit and a proposed Order but without the proposed retainer and fee agreement (App. A-59-60, 62; E-87-91; F-92-93). Without issuing a prior ten (10) day notice, on March 10, 1975, Judge Herzog signed the Order for Petitioner's retention and specified contingent compensation with no provision for further proceedings on compensation and the Order was entered in the docket as "fixing compensation" (App. A-62; F-92-93 Bankruptcy Court Docket, Order No. 10). The proposed retainer and fee agreement was then executed by the Arutt firm on March 21, 1975, and by Mr. Blanck on April 4, 1975, but the specified prior Court approval had not been sought or obtained. The Order and the executed retainer and fee agreement were mailed to Petitioner (App. A-69; F-92-93; G-94-98). The Arutt firm testified without rebuttal that the retainer and fee agreement had been shown to the Creditors' Committee at a meeting on March 16, 1975 (Hearing Tr., Arutt, pp. 142-146, Sachs, pp. 140-142).

In Contrast to the dismal prospects at the beginning of the case, from November, 1975, through September, 1976, Petitioner recovered $491,662 on the terminated contracts with the Government waiving its statutory set-off rights and without prejudice to the claims in the litigation. Then, under Judge Herzog's Order, Petitioner received the initial retainer of $15,000 on March 3, 1976, and, thereafter in 1976, compensation of $113,973.75. Each payment to Petitioner was reported on Futuronics' monthly operating statements to the Court. During this period, approximately one-half of the Arutt firm's time was billed to Petitioner and, as provided in the executed retainer and fee agreement, was paid for by Petitioner at no charge to Futuronics on three itemized hourly bills received by Petitioner

on March 24, 1976 ($14,154), July 12, 1976 ($12,937.50), and January 24, 1977 ($32,975.83) (App. A-66).

Petitioner never met Judge Herzog and only met successor Judge Lesser on three occasions prior to the successful end of the litigation. At a meeting with all parties, except Petitioner, on April 26, 1976, Judge Lesser had stated that he "was not too happy with" Judge Herzog's Order but that he was uncertain as to what he could do (Tr., April 26, 1976). Then, at Petitioner's first meeting with Judge Lesser on September 2, 1976, there was no mention of Judge Herzog's Order (Tr., September 2, 1976). At a meeting in November, 1976, again with Petitioner not present, Judge Lesser repeated that he was not happy with Judge Herzog's Order and stated that Petitioner should receive no further funds under that Order without a separate order by Judge Lesser (Undated Tr., filed January 4, 1977). At Petitioner's second meeting with Judge Lesser on December 26, 1976, no dissatisfaction with Judge Herzog's Order was expressed but Judge Lesser did state that he was going to write an opinion on compensation in the case, yet no such opinion was written (Tr., December 26, 1976). However, Judge Lesser then entered two Orders, on December 27, 1976 and February 10, 1977, for the payment of compensation and disbursements to Petitioner "Upon the Order of" Judge Herzog "subject to such further order as may be made concerning the fixing of final compensation." This compensation, totaling $53,406.25, was received in payments on January 28, 1977, and April 6, 1977.

In April, 1977, the Arutt firm submitted a fee application for its services as bankruptcy counsel which also reported to the Court the Arutt firm's expenditure of some 400 additional hours of professional services "with reference to the Government litigation for which applicants are not requesting compensation." The summary of hours and rates annexed to the application reaffirmed the point by stating, "No charge on services for government litigation." (App. A-54-55). Thereafter, in the late Spring, 1977, Judge Lesser wrote to the Arutt firm requesting that Petitioner be advised of Judge Lesser's reserva-

tions concerning Judge Herzog's Order. However, the Arutt firm replied by stating that Mr. Blanck and the Creditors' Committee had decided not to burden Petitioner with this information which might disrupt the pending litigation. Petitioner did not learn of this correspondence until August, 1979 (Hearing, August 2, 1979, Ct. Exh. 4, Raley Tr. pp. 141-143 and 155-158). Mr. Blanck replaced the Arutt firm with Schwartz and Sachs (the "Schwartz firm") as bankruptcy counsel in early September, 1977).

The Petitioner's third meeting with Judge Lesser was an unrecorded informal conference in late September, 1977. In his opinion on September 28, 1979, Judge Lesser recalled that at this conference he had explained "in part" his refusal to grant allowances because of a belief that Petitioner "had already been paid all, or about all, of its time costs on the Futuronics matter;" and that, while Petitioner urged the hardship that the case had created, Petitioner did not report its payment of the Arutt firm's bills (App. A-60-61). However, as of September 1, 1977, Petitioner had devoted 3,142.25 hours and expended $19,663.31 in disbursements on the claims and, with the last payment on April 6, 1977, had received the $15,000 retainer, $167,380 in contingent and hourly compensation, and $9,215.13 against the disbursements, and an even more intensive effort would be required to complete the pre-trial practice and conduct the trial (Record: Petitioner's Statement of Services, Time Sheets, and Summary of Time Sheets and Out-of-Pocket Expenses). Pursuant to the reason for the conference, Petitioner, Mr. Blanck, and the Creditor's Committee presented to Judge Lesser a proposed amendment to Judge Herzog's Order, which had been executed by Mr. Blanck and to which the Creditors' Committee had no objection, providing for payment of disbursements on a current basis and no further compensation to Petitioner from August, 1977 until the end of the case at which time graduated contingency rates would be applied to any additional funds finally recovered in excess of $2,000,000. (Hearing, I & R Exhs. 6 and 7, Raley Tr. Aug. 2, 1979, pp. 80, 83-86, and 100-110). Judge Lesser took no action on this pro-

posed amendment, yet Petitioner proceeded to the successful conclusion of the claims and litigation after the dedication of an additional 3,282.75 hours (Record: Petitioner's Time Sheets and Summary of Time Sheets and Out-of-Pocket Expenses). There was no discussion by anyone during the September, 1977, conference regarding Bankruptcy Rules, Petitioner's payment of the Arutt firm's bills, or the Arutt firm's report of services rendered on the contract claims and litigation at no charge to Futuronics.

At a meeting on December 14, 1977, with Petitioner again not present and the trial scheduled to start in February, 1978, Judge Lesser stated that, while the law is in "some chaos," he did not consider himself bound by Judge Herzog's Order, and "If Mr. Israel wants to get off the train, tell him to get off now." (Tr., December 14, 1977). No one told Petitioner "to get off the train," and on December 20, 1977, Judge Lesser entered an Order for the payment of Petitioner's outstanding disbursements from January through November, 1977. Then, on January 30, 1978, Judge lesser entered an Order for the payment of a private investigator on criminal allegations by the Government against Mr. Blanck, an Order for the prospective reimbursement of Petitioner's disbursements up to a ceiling amount, and a third Order providing for trial day fee payments without prejudice to Petitioner's rights under Judge Herzog's Order with the final compensation to be "fixed by further Order . . . on proper application."

In his opinion, Judge Lesser explained that he had decided to take no action to resolve compensation questions during the case until there was "a successful end of the litigation." (App. A-53-54 and 55). Petitioner received $36,000 in the trial day fees paid from July 28, 1978, to October 6, 1978, for the 45 day trial. Petitioner's dedicated pursuit of the claims and litigation resulted in (1) a full release of Futuronics' debt to the Government; (2) the payment of $4,650,000 in addition to the $491,662 previously recovered; (3) the Government's payment of unbooked general creditor/subcontractor claims against

Futuronics; and (4) additional Government payments of $168,604 as of February, 1980 (App. A-50, 55, 69; H and I; and Op. Statement, Feb. 1980). Petitioner submitted a proposed order for payment under Judge Herzog's Order which, based on the funds paid by the Government as of March, 1979, provided for total compensation of $1,314,393, less the prior payments of $218,380, for final compensation of $1,096,013.

Petitioner then requested and attended a meeting with Judge Lesser in March, 1979, which produced a letter of March 21, 1979, from Judge Lesser suggesting that Petitioner –

> "consider a submission justifying the compensation requested in accordance with the standards and procedures prescribed in Bankruptcy Rule 219. . . . I see no reason why the latter cannot be done without prejudice to your [Petitioner's] reliance on Judge Herzog's March 11 (sic: 10), 1975 order for determining the quantum of your compensation."

Petitioner immediately submitted its sworn "Statement of Services Rendered" of April 9, 1979, which gave a detailed description of the services rendered, hours worked, prior payments received, the services of the Arutt firm on the contract claims, and, for the first time in the proceeding, informed Judge Lesser of the Petitioner's payment of the Arutt firm's bills. In May, 1979, also for the first time in the proceeding, the secured creditor and the Creditor's Committee urged the Court to fix Petitioner's compensation under the criteria of Bankruptcy Rule 219(c) rather than Judge Herzog's Order. Also, for the first time in the proceeding, in May 1979, Mr. Blanck urged that Petitioner be denied all compensation because of the employment and payment of the Arutt firm. The resulting controversy produced extensive documentation, argument, and a six-day hearing at the conclusion of which Judge Lesser stated that it would be "grotesque" for Petitioner to be denied compensation (App. A-50-51, 56-57).

After Judge Lesser's opinion, the Creditors' Committee and Futuronics assured the Bankruptcy Court that there is sufficient cash to pay all creditors in full and leave a substantial equity for

the shareholders (Transcript, June 24, 1980). Further, Futuronics' counsel assured the Bankruptcy Court that "substantially less" than $3,100,000 would need to be paid on all valid remaining creditor claims (Letter, June 2, 1980, Mr. Blum). In September 1980, Mr. Blanck filed a Plan of Arrangement for the cash payment in full of all allowed claims. Futuronics has not conducted any manufacturing operations since January 1975; the bankruptcy proceeding is continuing; and, as a result of the accrual of interest on the deposited funds, Futuronics now has more than $6,000,000 in cash (Op. Statement, August 1981).

THE MAJORITY DECISION BELOW CONFLICTS WITH DECISIONS OF THIS COURT ON IMPORTANT ISSUES AFFECTING FEDERAL CONSTITUTIONAL DUE PROCESS RIGHTS; AND CONCERNS QUESTIONS OF FIRST IMPRESSION AND CONFLICTS WITH DECISIONS OF THIS COURT AND THE CIRCUIT COURTS ON THE CONSTRUCTION OF THE RULES GOVERNING BANKRUPTCY PROCEEDINGS AND THE JURISDICTION AND DISCRETION OF THE BANKRUPTCY COURTS.

Although Congress enacted a new Bankruptcy Act, effective October 1, 1979, this Court's Rules of Bankruptcy remain in effect and are cross-referenced throughout the new Act as defining and clarifying the procedure, practice, and authority of the Bankruptcy Courts. The questions in this case involving fundamental due process concepts of fair play and substantial justice are significant regardless of the statutory framework. Further, the questions involving the jurisdiction and discretion of the Bankruptcy Courts and the standards for appellate review are substantial with respect to both the majority's conflicts with decisions of this Court and the Circuit Courts as well as the matters of first impression in the construction and application of the Rules of Bankruptcy which superseded provisions of the old Act and are continued in effect under the new Act.

A. The Majority Decision Below Affirms a Complete Forfeiture of Rights based on a Prohibited Act Created by a Restrictive Construction of a Penal Provision.

The twice affirmed findings of the Bankruptcy Court establish: "[A]pproximately half the Arutt time spent on the case was billed to" Petitioner; compensation for this time was not requested from the estate, and the Arutt firm "reaffirmed the point by stating 'No charge on services for government litigation.' " Petitioner, "with some help from the Arutt firm, created the fund. They are the collective goose that laid the golden egg . . . . Blanck's knowledge of both the January 30 and March 3, 1975, retainer letters, and his signature on the latter are significant" (App. A-54-55, 66, 69). However, while recognizing that "sharing of compensation for contributed services is not improper," Judge Lesser concluded here that Petitioner had violated Bankruptcy Rule 219(d) by construing that Rule as limiting the permitted sharing of compensation for services "with any other attorney contributing thereto" to a retainer and a time period prior to the filing of a Chapter XI case (App. A-67-68). On appeal, neither the District Court nor the Second Circuit considered this restrictive construction but proceeded to impose a forfeiture based on the prohibited act thus created.

If former Section 62(d) of the Bankruptcy Act (11 U.S.C. § 102) had continued force and effect after the effective date of the Bankruptcy Rules, as held by the majority decision below, then the basis stated in that Section for imposing the penalty (sharing "contrary to the provisions of subdivision c of this section") must also have continued force and effect. The fact that Bankruptcy Rule 219(d) and superseded Sections 62(c) and (d) of the Act are penal provisions is undeniable. A provision which imposes a penalty for a forbidden act as an "arbitrary measure" is "[c]learly a penal statute" which "must be construed most favorably for those sought to be charged under it, and with strictness against their alleged liability" *Bolles v. Outing*, 175 U.S. 262, 264-265, 20 S. Ct. 94, 44 L.Ed. 156, (1899); *Chase v.*

Curtis, et al., 113 U.S. 452, 463-464, 5 S.Ct. 554, 38 L.Ed. 1038 (1884).

The standards for construing and applying penal provisions have been clearly expressed by this Court.

> "The case must be a strong one, indeed, which would justify a court in departing from the plain meaning of words, especially in a penal act . . ." [*United States v. Wiltberger*, 5 Wheat. 76, 95, L.Ed. 37, 42 (1820)]. "Before one may be punished, it must appear that his case is plainly within the statute; there are no constructive offenses' [*United States v. Resnick*, 299 U.S. 207, 209-210, 57 S.Ct. 126, 81 L.Ed. 127 (1936)]. "Penalties are never extended by implication. They must be expressly imposed or they cannot be enforced" [*Elliott v. The East Pennsylvania R. Co.*,99 U.S. 573, 576, 25 L.Ed. 292 (1879)].
>
> "That the terms of a penal statute . . . must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties, is a well recognized requirement, consonant alike with ordinary notions of fair play and the settled rules of law. And a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law . . . Penal statutes . . . should not admit of such a double meaning that the citizen may act upon the one conception of its requirements and the courts upon another." [*Connally v. General Construction Co.*, 269 U.S. 385, 391, 393, 46 S.Ct. 126, 70 L.Ed. 322 (1926); *United States v. Culbert*, 435 U.S. 371, 373-374, 98 S.Ct. 1112, 55 L.Ed. 2d 349 (1978); *United States v. Batchelder*, 442 U.S. 114, 123, 99 S.Ct. 2198, 60 L.Ed. 2d 755 (1979)].

Under former Section 62, a sharing of compensation for services with "any other person . . . contributing thereto" and by an attorney-at-law with "a forwarding attorney-at-law" were not "contrary to the provisions of subdivision c" and did not result in a penalty under subdivision d. Under Rule 219(d) a sharing of

compensation for services "with any other attorney contributing thereto" is not an act which "violates this subdivision" giving rise to a penalty. The Advisory Committee Note to Rule 219(d) states that sharing of compensation is not authorized –

> ". . . unless the attorney sharing in the compensation has contributed to the services for which the compensation is allowed. This . . . harmonizes the practice . . . with Canon 34 and Disciplinary Rule 2-107."

Canon 34 and DR 2-107 likewise permit a division of compensation if the division is with another attorney with the client's consent and is in relation to the services performed and does not result in total compensation clearly exceeding reasonable compensation. Further, the primary treatise on the subject echoes the Advisory Committee by stating that, under Rule 219(d) agreements to share compensation are prohibited "if concluded with any person not contributing to the services to be compensated. . . ."[Collier on Bankruptcy, ¶62.37, at 1637 (1975)].

On this record, there was no prohibited act under the explicit language of former Section 62(c) of the Bankruptcy Act, Bankruptcy Rule 219(d), and Canon 34 and DR 2-107. This conclusion is buttressed by the case law on the specific subject. *In re Barceloux,* 74 F.2d 288 (9th Cir. 1934), involved a situation where, without the Court's knowledge, the trustee's counsel, Devlin & Devlin, was assisted by another attorney, Freeman, who also represented the largest creditor. As opposed to the instant case, when Devlin & Devlin applied for compensation they sought reimbursement for the compensation they had paid to Freeman, which was in addition to funds received by Freeman from the creditor. Another creditor urged the denial of compensation, but the Ninth Circuit held:

> ". . . it must be admitted . . . that Freeman, in assisting to recover the $125,000 for the estate, was not working against the interests of the estate . . . Devlin & Devlin were . . . the attorneys . . . and to them only could a fee be allowed. Any expense incurred by Devlin & Devlin for legal assistance in the premises is not a charge against the bankrupt's estate, and this court is not concerned as to ar-

rangements Devlin & Devlin may have made for the payment for such legal assistance." Id., at pp. 294-295.

In *Application of Pinetree Associates,* 77 F. Supp. 270, 271 (E.D.N.Y. 1948), the Court considered an agreement to share compensation by a debtor's attorney with another law firm under the provisions of former Section 62(c) and (d) of the Bankruptcy Act (11 U.S.C. § 102 c and d), and held:

> ". . . the agreement at bar is not improper . . . 11 U.S.C.A. § 102, sub. c . . . the referee has found that the attorneys who are sharing compensation with the attorney for the debtor actually contributed to the services rendered. . . ."

Further, this Court has established the principle that in determining whether conduct is improper, the court must look to the totality of the actions and consequences. Service which –

> ". . . is in good faith and with a due regard to . . . oblitions, legal and equitable, to the [beneficiaries] . . . but also . . . beneficial and advantageous to [all parties] . . . [renders] the criticized transactions . . . not only exonerated of evil or illegal intent but . . . also . . . beneficial rather than injurious to the interests which now challenge them." [*Comstock v. Group of Investors,* 335 U.S. 211, 230, 68 S.Ct. 1454, 92 L.Ed. 1911 (1948].

Yet, based on findings that, with Futuronics' agreement, Petitioner paid the bills, at no charge to the estate, for the Arutt firm's help in creating the funds for the benefit of the creditors and shareholders alike, Judge Lesser concluded that a prohibited sharing of compensation had occurred by restricting the phrase "contributing thereto" to a retainer and a time period prior to the filing of a Chapter XI case. The "prohibited sharing" thus created by Judge Lesser produced the "forfeiture" on appeal. The creation of a prohibited act by this restrictive construction is directly contrary to the standards established by this Court for the construction and application of a penal provision. Further, a penalty, particularly a total forfeiture, based on this restrictive construction is unenforceable because the distinc-

tion between a prohibited act and a permitted payment for contributed services by another attorney has been rendered so vague that persons of ordinary intelligence would have to guess at its meaning and differ as to its application. In fact, the precedents are now in total conflict on this specific subject.

B. The Majority Decision Below Disregards the Amount of and the Vested Right to Compensation from Funds Created as a Result of the Performance of Services under a Fully Executed Retainer and Fee Agreement and a Bankruptcy Court Order, which had not been Reconsidered, Vacated, Set Aside, or Reviewed.

The twice affirmed findings of the Bankruptcy Court establish that Futuronics was authorized to retain Petitioner by the Order of March 10, 1975, for the performance of all services on the contract claims and counterclaims and set-offs with specified compensation out of recovered funds. On April 4, 1975, without the specified prior court approval, Mr. Blanck executed the retainer and fee agreement reiterating these compensation terms and providing for Petitioner's hourly employment of the Arutt firm. During the performance of the services, $491,662 was recovered, Petitioner received compensation, and Petitioner paid the Arutt firm's hourly bills for services in helping to create the funds without charge to Futuronics. Further, during the performance of the services, although Judge Lesser expressed some reservations concerning Judge Herzog's Order, but not when Petitioner was present, he authorized the payment of compensation to Petitioner based upon that Order or without prejudice to Petitioner's reliance on that Order subject only to a caveat that final compensation would be made on a further order upon a proper application. At no time until after the completion of all services and the final recovery of the funds, was a need or desire for a statement conforming to Bankruptcy Rule 219 suggested or indicated by any party or the Court nor was any appeal from, request for review or reconsideration of, or objection or opposition to Judge Herzog's Order or the executed retainer and fee agreement filed by any party. Until September 28, 1979, the Order of March 10, 1975,

had not been vacated, modified, or set-aside. Judge Lesser explained that, due to the "uncertain outcome" of the litigation, during the performance of the services he decided to take no action on any compensation questions in the case because "it would be wasteful to adjudicate" these matters "before there was a meaningful recovery against the government . . . if, as and when there was a successful end of the litigation" (App. A-53-54, 55).

The crux of the decisions below on improper conduct by Petitioner rests on the conclusion that Petitioner should not have relied on Judge Herzog's Order as fixing the right to compensation out of funds created by the specified services; but rather, in receiving compensation payments, Petitioner should have submitted statements for allowances "from the estate" under Rule 219(a), which would thus have produced a report of the payment of the Arutt firm's bills. Four and one-half years after Judge Herzog's Order, Judge Lesser concluded that, until Petitioner filed its "Statement of Services" in the proceedings on final compensation, Petitioner had violated Bankruptcy Rule 219(a) in not submitting statements under that Rule whenever compensation was paid because, when Judge Lesser expressed reservations, in Petitioner's absence, concerning the Order of March 10, 1975, and "particularly after the Court announced in Petitioner's absence] that it would not be bound by" that Order, Petitioner must be held responsible for knowledge of Bankruptcy Rules 215 and 219 and "[i]t is unthinkable that they did not at least research how good their case was on making Judge Herzog's order stick. . . ." (App. A-61-62). On September 28, 1979, Judge Lesser decided that the Order of March 10, 1975, was effective only in giving Petitioner official status to represent Futuronics and was not final as to compensation; and, accordingly, Bankruptcy Rule 219(a) had governed compensation during the proceeding, as Petitioner should have known. On appeal, Judge Duffy simply reiterated Judge Lesser's position and the majority of the panel for the Second Circuit did not consider it necessary to address these questions (App. A-9 & 13, n.7 and n.11). Judge Lesser's ruling was predicated on four grounds:

First, Judge Lesser concluded that Judge Herzog's Order 1975, was not final because Futuronics' application, prepared and signed by the Arutt firm, did not comply with Rule 215 in that it did not disclose the provision in the proposed retainer and fee agreement of March 3, 1975, for the Arutt firm's employment (App. A-62).[1] However, the proposed retainer and fee agreement was executed by the Arutt firm and by Mr. Blanck without the specified prior Court approval; and Judge Herzog's Order and the executed retainer and fee agreement were mailed to Petitioner. Petitioner was not the "applicant" under Rule 215; Petitoner did disclose its "connection" with the Arutt firm; Petitioner's only contact with the Court was through the Arutt firm and Mr. Blanck; Petitioner had no interest adverse to the estate; and Petitioner's total knowledge consisted of receiving the Order and the executed retainer and fee agreement which required Court approval prior to such execution.

Second, Judge Lesser concluded that Judge Herzog's Order was not final because the court had not issued a ten-day notice to interested parties under Rule 11-24(a)(7) and, therefore, Judge Lesser assumed that Judge Herzog could not have intended a final order (App. A-62-63). However, Rule 11-24(a)(7) concerns a hearing on an "application for allowances" from the estate, but the Order specified compensation out of recovered funds. The Order also made no reference to the need for further proceedings on compensation and was entered as "fixing compensation." Petitioner cannot be charged with improperly relying on an Order when the court did not issue a required notice or a successor Judge assumes that his predecessor did not intend to do what he did. Further, the Circuit Courts, until the majority decision below, had consistently held that "[i]t is incumbent

[1] Judge Lesser also referred to the failure of Mr. Blanck to sign the application and a lack of disclosure of the discarded January 30, 1975 proposed retainer and fee agreement. However, Mr. Blanck's signature was not required (Bankruptcy Rule 911 and 11-63) and the terms of the discarded January 30, 1975, proposal had been presented to the Court. (App. A-59).

upon the creditors to follow the record of the administration of the bankruptcy estate and discover for themselves the orders which they may want to challenge" [*In re General Insecticide Co.*, 403 F.2d 629, 630 (2nd Cir. 1968)]. As recognized by the Advisory Committee Note to Rule 11-24, a waiver of notice may occur as a result of conduct by the interested parties; and the doctrine of laches has been enforced to deny a challenge to an order in bankruptcy long after entry of the order [*Feldman v. Trans-East Air, Inc.*, 497 F.2d 352, 355-356 (2nd Cir. 1974); *Petition of Baxter*, 269 F.344, 348, 351 (6th Cir. 1920); *Connelly v. Hancock, Dorr, Ryan & Shove*, 195 F.2d 864, 868-869 (2nd Cir. 1952)].

Third, Judge Lesser concluded that Judge Herzog's Order was not final because it was an "administrative order" subject to "horizontal review and reconsideration by the Court at any time" (App. A-74-75). However, when Section 39(c) of the Bankruptcy Act was amended in 1960, Congress intended to overrule the basis used by Judge Lesser for this conclusion, *Pfister v. Northern Illinois Finance Corp.*, 317 U.S. 144, 63 S.Ct. 133, 87 L.Ed. 146 (1942), in favor of the finality of a referee's order as a jurisdictional matter if no review was sought within ten days of its entry [S. Rep. No. 1689, 86th Cong., 2nd Sess., 1960 U.S. Code Cong. & Admin. News, Vol. 2, at 3194-3197; *In re Benefiel*, 500 F.2d 1219, 1220-1221 (9th Cir. 1974); *In re Bad Bubba Racing Prods., Inc., 609 F.2d 815, 816 (5th Cir. 1980); Martin v. First National Bank of Masillon*, 573 F.2d 958, 959 (6th Cir. 1978); *In re Brendan Reilly Associates, Inc.*, 372 F.2d 235, 238-239 (2nd Cir. 1967)]. Further, Bankruptcy Rules 801, 802, 803, and 924 –

> ". . . do not preserve . . . the practice pertaining to so-called 'administrative orders', which have been regarded as subject at any time to reconsideration by the referee or to review by the district court without regard to the limitation of § 39(c) of the Act . . . ." [Advisory Committee Note to Rule 924].

Fourth, Judge Lesser concluded that Judge Herzog's Order was not final because Petitioner's performance created no

vested rights or whatever vested rights were possessed by Petitioner would not be prejudiced by applying Bankruptcy Rule 219. (App. A-75-76).

This Court has consistently upheld the exclusive jurisdiction of the bankruptcy court to fix the amount of compensation for services in the bankruptcy administration or in special litigation before a separate forum [*Brown v. Gerdes*, 321 U.S. 178, 64 S.Ct. 487, 88 L.Ed. 659 (1944)]. However, no decisions define a specific point in time as proper for the exercise of this jurisdiction over the amount and, in its last statement on the specific subject [*Brown, supra.*, 321 U.S., at 188], this Court did not reach the question of whether the right to compensation was a lien created by substantive law. Judge Herzog's Order was certainly the exercise of a power to fix the amount of compensation for all Government contract services, thus invoking the question of whether it was exercised at the proper time and was subject to "horizontal" reconsideration and reduction or review more than four years later. However, the Order also specified that the compensation was to be paid out of funds recovered, and not out of existing assets, thus giving rise to a second question of whether that Order established or resulted in the creation of a substantive vested right to compensation out of funds successfully recovered on which right Petitioner could properly and reasonably rely as the basis for compensation.

Under New York law, the compensation of an attorney is governed by agreement which is not restrained by law and, from the commencement of any action in any court or federal department, the attorney has a lien upon his client's cause of action, claims and the proceeds thereof wherever located which lien is paramount and enforceable by the court. [New York Judiciary Law, Art. 15, Sections 474 and 475; *In re Washington Sq. Slum Clearance, etc.*, 184 N.Y.S. 2d 585, 589-591, 596, 5 N.Y.2d 300 (C.A. 1959); *Desmond v. Socha*, 327 N.Y.S.2d 178, 180-181, 38 A.D.2d 22 (App. Div. 1971), *affirmed*, 337 N.Y.S.2d 261 (C.A. 1972)]. This attorney's lien law has been construed and applied in bankruptcy proceedings as enforceable upon the cause of action and the fund created, either by judgment or settlement [*In*

re Shirley Duke Assoc., 611 F. 2d 15, 18-19 (2nd Cir. 1979); *In re Pathe News, Inc.*, 276 F. Supp. 670, 671-672 (S.D.N.Y. 1967)]. In addition, decisions of this Court have consistently upheld the common or equitable fund doctrine, which "prevails in bankruptcy cases", under which an attorney has an enforceable lien for compensation out of funds created prior to the estate's legal receipt of such funds [*Trustees v. Greenough*, 105 U.S. 527, 534, 26 L.Ed. 1157 (1882); *Central Railroad v. Pettus*, 113 U.S. 116, 127-128, 5 S.Ct. 387, 29 L.Ed. 915 (1885); *Randolph v. Scruggs*, 190 U.S. 533, 539, 23 S.Ct. 710, 47 L.Ed. 1165 (1903); *Sprague v. Ticonic Bank*, 307 U.S. 161, 167, 59 S.Ct. 777, 83 L.Ed. 1184 (1939); *Alyeska Pipeline Co. v. Wilderness Society*, 421 U.S. 240, 257-258, 95 S.Ct. 1612, 44 L.Ed. 2d 141 (1975); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed. 2d 593 (1970); *Boeing Co. v. Van Gemert*, ____U.S.____, 100 S.Ct. 745, 749-751, 62 L.Ed. 2d 167 (1980)]. In reciting at the outset that compensation for the Government contract services shall be paid out of the funds recovered rather than from existing funds, Judge Herzog's Order expressed the same right set forth under New York State law and the common or equitable fund doctrine and that right attached to the claims and to the funds recovered before they became part of the estate.

Furthermore, the decisions of this Court established the doctrine of vested rights which barred a referee from vacating a prior order in bankruptcy if that order had created vested rights which its vacation would disturb [*Wayne United Gas Co. v. Owens-Illinois Glass Co.*, 300 U.S. 131, 137, 57 S.Ct. 382, 81 L.Ed. 557 (1937); *Sandusky v. National Bank*, 90 U.S. (23 Wall.) 289, 293, 23 L.Ed. 155 (1875); Cf. *In re Pottasch Brothers Co.*, 79 F.2d 613, 616-617 (2nd Cir. 1935)].

By reconsidering and setting aside Judge Herzog's Order four and one-half years after the fact, Bankruptcy Judge Lesser not only reduced the amount of compensation specified in that Order to $1,040,000, an amount he found reasonable under Bankruptcy Rule 219(c), but, until Petitioner's "Statement of

Services" in response to Judge Lesser's "suggestion", conforming to Rule 219(b), he also charged Petitioner with prior improper conduct under Rule 219(a) because he found it "unthinkable" that Petitioner would rely on an unchallenged and unaltered right to be compensated out of funds recovered under the original Order and the executed retainer and fee agreement, as well as New York law and decisions of this Court. In concluding that there was no need to consider the rights defined by the Order of March 10, 1975, the majority decision below upheld conclusions which are in direct conflict with the language and intent of Section 39(c) of the Bankruptcy Act and Bankruptcy Rules 801, 802, 803 and 924, and which ignore the laches of the creditors and Futuronics, and which not only disturbed but also penalized Petitioner for relying on rights which were consistent with substantive state law and decisions of this Court.

C. The Majority Decision Below Conflicts with the Bankruptcy Rules and the Decisions of this Court and the Circuit Courts Defining the Jurisdiction and Discretion Vested in the Bankruptcy Court.

Contrary to the majority decision below, the legislative history of former Section 62(d) of the Bankruptcy Act does not indicate a clear intent or policy to divest the bankruptcy court of discretion. In introducing H.R. 6439, with his mimeographed sheet of changes to Section 62(d), including the provision "shall withhold", Representative Chandler stated that the Section was rewritten "without change in substance" and was intended to be the "counterpart" of his changes to Section 48e, which stated "[t]he court may, in its discretion, withhold . . ." [H.R. 6439, April 15, 1937, Mimeographed Cover Sheets, Sections 48e and 62(d); Attorney General's Committee on Bankruptcy Administration, Vol. 16, Item 10 (1941), Supreme Court Library]. However, this Court does not need to reach this question of legislative intent.

Congress explicitly declared that, when effective "[a]ll laws in conflict with such [Bankruptcy] rules shall be of no further

force or effect . . . " (28 U.S.C. § 2075). Consequently, on October 1, 1973, Mr. Chandler's words "shall withhold" became, under Rule 219(d). "the court may deny him compensation, may hold invalid any transaction . . ., or may enter such other order as may be appropriate." Former Sections 62(c) and (d) of the Bankruptcy Act "are superseded by these rules" and "[a]ll allowances of compensation . . . are exercises of the court's discretion" [Advisory Committee Note to Rule 219]. Rule 219(d) "supersedes § 62c and § 62d so far as § 62d prescribes penalties . . . It is important to note that the rules do not make forfeiture of compensation mandatory" [Collier on Bankruptcy, § 62, p. 1383, Rel. No. 21-1975; and ¶62.12 at 1464 (1975)].

This Court and the Circuit Courts have consistently held, until the majority decision below, that the use of the word "may" vests a very broad discretion and, in bankruptcy where the court 'may order" or "may deny the allowance", the trial judge is vested with the discretion in finding compensation and sanctions; and the parties have a right to the exercise of that discretion. [*Shulman v. Wilson-Sheridan Hotel Co.*, 301 U.S. 172, 57 S.Ct. 680, 81 L.Ed. 986 (1937); *Dickinson Industrial Site v. Cowan*, 309 U.S. 382, 385, 60 S.Ct. 595, 597, 84 L.Ed. 819 (1940); *Federal Land Bank of Springfield v. Hansen*, 113 F.2d 82, 83-84 and (2nd Cir. 1940); *In re Herz, Inc.*, 81 F.2d 511, 512-513 (7th Cir. 1936); *In re American Mail Line*, 115 F.2d 196, 198 (9th Cir. 1940); *Gochenour v. Cleveland Terminal Bldg. Co.*, 142 F.2d 991, 995 (6th Cir. 1944); *In re Haldeman Pipe & Supply CO.*, 417 F.2d 1302, 1305 (9th Cir. 1969)].

The majority decision below is in direct conflict with the Bankruptcy Rules, their implementing legislation, and decisions of this Court and the Circuit Courts in affirming a reversal of the findings of the trier-of-fact on the basis that there was no discretion and a forfeiture was mandatory. As recognized by the dissent below, questions of compensation and penalties are strictly matters of judicial discretion; and Petitioner had a right to the exercise of that discretion. Since this case involves neither

an undisclosed conflict of interest by Petitoner nor insider trading in the debtor's securities nor Petitioner acting without an order authorizing its retention nor an effective statute, order, or rule prohibiting the exercise of discretion and mandating a forfeiture, the sole ground used for substituting a forfeiture for the findings of the trier-of-fact was *Arlan's Department Stores, Inc., supra.*, which the dissent below would "wholly distinguish."

In contrast to the record in this case, *Arlan's Department Stores, Inc., supra.*, was a pre-Bankruptcy Rule case which involved pre-bankruptcy connections and a fee-splitting agreement between attorneys, without the client's knowledge or consent, based on a "trafficking in bankruptcy appointments"; substantial funds were stripped from the estate's working capital without the court's knowledge and in one instance funds were taken from an escrow account in direct violation of a Court order; a senior partner became a director and the secretary of the debtor and funds taken from the estate were not reported to the court; and, within nine months after the Chapter XI case was filed, it was a "disaster" and was converted to a Chapter X proceeding. Accordingly, the trier-of-fact, denied all compensation [*Arlan's Department Stores, Inc.*, 462 F. Supp. 1255 (S.D.N.Y. 1978)]. On appeal, contrary to the majority decision below, the Second Circuit affirmed on the basis of "the inherent power of a bankruptcy judge" and the basic principle that the reviewing court "will not interfere with the . . . assessment of the compensation to be awarded attorneys in bankruptcy proceedings absent a clear abuse of discretion." [Id., 615 F.2d 925, 943 (2nd Cir. 1979)].

Until the majority decision below, clear standards had been established for the exercise of the discretion vested in the bankruptcy court:

> "A bankruptcy court is . . . guided by equitable doctrines and principles . . . A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief . . . [and] adjust the remedy to meet the need . .

> . the range and type of the power which a court of bankruptcy may exercise . . . is ample for the exigencies of varying situations." [*American Ins. Co., v. Avon Park*, 311 U.S. 138, 145-146, 61 S.Ct. 157, 85 L.Ed. 91 (1940); Cf. *Bank of Marin v. England*, 385 U.S. 99, 103, 87 S.Ct. 274, 17 L.Ed. 2d 197 (1966)].

Services, which are in good faith with a due regard to the beneficiaries and are advantageous to all parties, render criticised transactions "not only exonerated of evil or illegal intent but also . . . established as beneficial rather than injurious to the interests which . . . challenge them." [*Comstock v. Group of Investors, supra.*].

> "It is clear from the opinion in *Woods [Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 61 S.Ct. 493, 85 L.Ed. 2d 820 (1971)] that the Court was considering the power of a . . . court to deny compensation, not its obligation to do so . . . this power derives from the 'bankruptcy court['s] . . . plenary power to review all fees and expenses.'. . ." [*New York, N.H. & H.R. Co. v. Iannotti*, 567 F.2d 166, 174-175 (2nd Cir. 1977), *cert. den.*, 98 S.Ct. 120 (1977)].
>
> "[W]e think that the consequences should be only those which attend any breach of trust in equity: i.e., that in determining what the . . . compensation shall be, the court will, as a matter of discretion, diminish the allowance which it would otherwise make in proportion to the gravity of the breach [and the extent that it impaired his] service in the interest of those for whom the claimant purported to act . . . It would strip the . . . court of equity of its authority to exercise sound discretion [to hold that] it must close its eyes to the equities and disallow any and all payments . . . The thread that runs consistently through the cases is that the remedy granted or penalty imposed by equity must be tailored to fit the particular case at hand." [*New York, N.H. & H.R. Co. v. Iannotti, supra.*, at 173, 174, 176; *Berner v. Equitable Office Building*, 175 F.2d 218, 220-222 (2nd Cir. 1949); *Silbiger v. Prudence Bonds Corp.*, 180 F.2d 917, 921 (2nd Cir. 1950); *cert. den.*, 340 U.S. 813 (1950)].

A review of the decision of a bankruptcy judge on appeal to the district court or the circuit court is subject to the standards prescribed in Rule 52(a) of the Federal Rules of Civil Procedure (Bankruptcy Rules 801, 802, 803, and 810, Advisory Committee Note to Rule 810). Clearly erroneous means that the reviewing court "on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Fee allowances and sanctions are findings based on sound equitable discretion in reconciling competing claims to reach an overall fair resolution and "are not reviewable except where a clear abuse of discretion is apparent." [*United States v. Gypsum Co.*, 333 U.S. 364, 395, 68 S.Ct. 525, 921 L.Ed. 746 (1948); *Katchen v Landy*, 382 U.S. 323, 327, 86 S.Ct. 467, 15 L.Ed. 2d 391 (1966); *Dickinson Industrial Site, supra.*, at 389; *Reconstruction Finance Corp. v. Denver & Rio Grande West R. Co.*, 328 U.S. 495, 533, 66 S.Ct. 1282 & 1384, 90 L.Ed. 1400 (1946); *Comstock, supra.*, at 230]. The rule, which has been described as "universal" throughout the Circuits, is that the reviewing court will not interfere with the trial court's assessment of compensation and sanctions absent a sustaining of the very heavy burden of showing a clear or gross abuse of discretion amounting to a failure to act conscientiously and fairly, an obvious miscarriage of justice, or a manifest disregard of right and reason.

If every post-bankruptcy payment to another attorney for contributed services with the client's consent is a prohibited act and if Petitioner could not and had no right to rely on Judge Herzog's Order and the executed retainer and fee agreement, then Judge Lesser's opinion is fully consistent with the proper exercise of his jurisdiction and discretion in imposing a penalty for "the 219 problem" against the compensation otherwise due under Rule 219(c) in order to tailor a remedy which would act as a disciplinary sanction while avoiding an "unjustified windfall for the creditors and shareholders alike."

On review, Judge Duffy's substitution of a forfeiture, with which "others may disagree", as required by the wholly distinguishable facts in another case, demonstrated neither a

definite and firm conviction nor established a clear or gross abuse of discretion in Judge Lesser's findings (App. A-48 & n.3). The majority decision below upheld the substituted forfeiture by ignoring the findings and concluding that discretion was barred by a former penalty having no force or effect (App. A-17).

With respect to the exercise of discretion, we briefly note the following cases. In *Watkins v. Sedberry*, 261 U.S. 571, 576-577, 43 S.Ct. 411, 67 L.Ed. 802 (1923), the "attorney rendered valuable services in the prosecution of a proper and legitimate suit and though his efforts there was recovered more than enough to pay expenses and debts in full . . . The attorney's right to fair and reasonable compensation is not forfeited" even though he had entered a clearly champertous agreement with the trustee. Under *Calton Crescent, Inc.*, 173 F.2d 945, 946 (2nd Cir. 1949); *affirmed sub nom., Manufacturers Trust Co. v. Becker*, 338 U.S. 304 70 S.Ct. 127, 94 L.Ed. 107 (1949), on the question of imposing a penalty, if an unharmed beneficiary is "allowed to prevail, . . . it can only be as a disciplinary measure" and, "where the beneficiary knew of and consented to" the act, "that is a controlling factor and it gives the court full discretion to deny the surcharge." A "disciplinary sanction,", is "within the discretion of the court to impose or withhold [and] where there was no overreaching . . .we are not convinced that the circumstances are such as to require the imposition of the sanction. . ." [Id., 173 F.2d, at 950]. In *Lewis v. Teleprompter Corp.*, 88 F.R.D. 11 (S.D.N.Y. 1980), decided 22 days after Judge Duffy's opinion below, lead counsel ("Wolf Popper") applied for fees in a settled shareholder class action with a $2,725,000 recovery. Other parties brought to light threshhold agreements by Wolf Popper, without the client's knowledge, to pay two other attorney's a percentage of Wolf Popper's fees for agreeing "to furnish" their clients (Id., pp. 16-17 and 20-22). The Court refused to impose Judge Duffy's forfeiture on the basis that a "decided benefit was conferred" on all parties and it was apparently never "drawn to counsel's attention" that such agreeements were not countenanced. The Court imposed a

$50,000 disciplinary penalty against the $367,200 fee which was otherwise due for Wolf Popper's 2,536 hours on the case, abilities demonstrated, difficulties encountered, and results achieved (Id., pp. 23-24). Finally, *Stolkin v. Nachman*, 472 F.2d 222, 226-227 (7th Cir. 1974), involved a total noncompliance with General Order 44 and a substantially similar factual record to the instant case, in that no objection was raised until after the successful end of the attorney's services and the bankruptcy court proceeded during the rendering of the services without a question as to compliance with the General Order. As the Seventh Circuit held in *Stolkin*:

> "There is no showing that [the attorney] represented any interest adverse to the estate or to the debtor-in-possession . . . .Here every creditor has been paid in full and a substantial amount has been left for the debtor. This not a case of a creditor complaining about non-compliance . . . but that of the debtor himself who retained the attorney initially and throughout and who would be the only one to profit if the fees were disallowed. Interim fees were allowed but [the debtor] did not conceive the necessity of hiring another counsel to oppose these nor did he object to them . . . If we were to take the position that [the attorney] was blocked from any claim for compensation for his services in these far from easy proceedings, we would have a formalistic but meaningless adherence to the General Order . . . and would be ignoring the words of the Supreme Court in *Bank of Marin v. England*, 385 U.S. 99, 103, 87 S. Ct. 274, 277, 17 L.Ed. 2d 1977 (1966) . . . ."

D. The Majority Decision Below Conflicts with the Express Provisions of Bankruptcy Rule 215 in Holding that an Attorney Making Full Disclosure to the Applicant is Responsible for a Non-Disclosure in the Application for the Authority to Permit His Retention.

Bankruptcy Rules 215(a) and (b) and 11-2(3) impose obligations on two parties. An attorney can only be employed upon the application of the debtor-in-possession, signed by the debtor or an attorney of record for the debtor [Bankruptcy

Rules 911 and 11-63] with the application stating "to the best of the applicant's knowledge" all of the proposed attorney's "connections with the [debtor] . . . and . . . respective attorneys." Because of the applicant's need to obtain the required "knowledge", the Rules provide that the bankruptcy judge "may" impose sanctions against the proposed attorney if he has or had any undisclosed "interest adverse to the estate" or sanctions against the "applicant" if "he failed to make diligent inquiry into the connections of such attorney." The Advisory Committee Note to Rule 215 states that an undisclosed interest in no way adverse to the estate should afford the court no basis for denying compensation to an attorney.

The Bankruptcy Court did not find or hold that Petitioner failed to comply with Bankruptcy Rule 215. On appeal, Judge Duffy did not address this specific question; but, after referring to some cases in which compensation was denied or reduced because of undisclosed actual conflicts of interest, attorneys stripping funds from the operating capital of an estate without the court's knowledge, and failures to be retained under a court order, the majority decision below stated "Rule 215 expressly required the Israel firm to disclose all 'connections' it had with the attorneys for the debtor. This it failed to do." (App. A-15).

However, the twice affirmed findings of the Bankruptcy Court establish: first, Petitioner was not the "applicant" for its own retention and had no contact with the Bankruptcy Court other than through the Arutt firm and Mr. Blanck; second, Petitioner's "connection" to the Arutt firm was fully disclosed to the "applicant" by virtue of the terms of the discarded proposed fee agreement of January 30, 1975, which were presented to the court, and the March 3, 1975, retainer and fee agreement executed by the Arutt firm and by Mr. Blanck without with the specified prior Court approval; third, the application for the Order of March 10, 1975, was prepared and signed by the Arutt firm on Futuronics' behalf, as provided in Bankruptcy Rule 911, but it did not include the proposed retainer and fee agreement of March 3, 1975, in spite of the requirement for court approval

prior to execution; and, fourth at no time did Petitioner have an adverse interest to the estate.

Petitioner required the court's prior approval of the retainer and fee agreement, which recited the Arutt firm's employment, but the agreement was executed without complying with that requirement. Further, Petitioner's lack of an adverse interest to the estate is self-evident from the totally dedicated pursuit of the contract claims and rights for four years; the payment for the Arutt firm's services at no charge to the estate and with Futuronics' express agreement; the expenditure of 6,425 hours on the cases under an Order and an agreement which made compensation contingent on Petitioner's success in creating new funds and which prevented the performance of any significant work on other litigation; and the creation of funds and benefits permitting the full payment of creditors and substantial equity for shareholders.

CONCLUSION

After devoting what constituted virtually four years of Petitioner's professional life to the totally dedicated and enormously successful pursuit of claims and rights on behalf of the client, Petitioner has been denied all compensation under either the initial Order authorizing Petitioner's retention and the executed retainer and fee agreement or the subsequent Opinion and Order of the trier-of-fact in applying Bankruptcy Rule 219. It is respectfully submitted that no statute, rule, policy or precedent requires, supports, or condones the grotesque injustice wrought by the majority decision below. For all the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

MORTIMOR S. GORDON
460 Park Avenue
New York, New York 10022
Telephone: (212) 838-4600
Counsel for Petitioner

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of December, 1981, three copies of this Petition were mailed, first class postage prepaid, to Gary L. Blum, Esq., 425 Park Avenue, New York, New York 10022, Counsel for Futuronics Corporation, Respondent, and to Alex Spizz, Esq., 292 Madison Avenue, New York, New York, Counsel for Arutt, Nachamie, Benjamin, Lazar & Kirschner, P.C., formerly Arutt, Nachamie, and Benjamin. I further certify that all parties required to be served have been served.

Mortimor S. Gordon
Counsel for Petitioner

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 507, 566, 885,
886, 887 September Term, 1980

Docket Nos. 80-5032, 80-5033, 80-5046,
80-5048, 80-5050

In the Matter of
FUTURONICS CORPORATION,

Debtor.

FUTURONICS CORPORATION,
Debtor-Appellee-Cross-Appellant,

v.

ARUTT, NACHAMIE & BENJAMIN and ARUTT,
NACHAMIE, BENJAMIN, LAZAR & KIRSCHNER, P.C.,
Appellants-Cross-Appellees,

ISRAEL & RALEY,

Appellant-Cross-Appellee.

Before: OAKES and MESKILL, *Circuit Judges,* and SAND,* *District Judge.*

On Petition for Rehearing

Appellant Israel & Raley having petitioned for rehearing, it is ORDERED:

*Honorable Leonard B. Sand, United District Judge for the Southern District District of New York, sitting by designation.

1. The material on page 4113 of the opinion reading:

> We do not interpret Rule 219(d), which supersedes the latter provision, as contemplating the imposition of less severe sanctions; rather, the rule was intended to make available *additional* sanctions such as removal from office or dismissal from employment. *See Advisory Committee Note to Rule 219.*

is modified to read:

> Although Rule 219(d), which supersedes the latter provision, now casts the sanction for violation of the prohibition in discretionary terms *(i.e.,* "the court *may* deny him compensation"), the principal purpose for the revision of the Rule was not to dilute its underlying policy but to make available additional discretionary sanctions such as removal from office or dismissal from employment. *See Advisory Committee Note to Rule 219;* 12 Collier, *supra,* at 2-221.

2. The petition for rehearing by the panel is denied.

I adhere to my dissenting opinion.

/s/ *James L. Oakes*
JAMES L. OAKES, U.S. Circuit Judge

/s/ *Thomas J. Meskill*
THOMAS J. MESKILL, U.S. Circuit Judge

/s/ *Leonard B. Sand*
LEONARD B. SAND, U.S. Distrit Judge

Dated: August 7, 1981
Filed: September 4, 1981

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Filed July 02 1981

Nos. 507, 566, 885, 886, 887 September Term, 1980

(Argued March 27, 1981 Decided July 2, 1981)

Docket Nos. 80-5032-3, 80-5046-8, 80-5050

In the Matter of
FUTURONICS CORPORATION,

Debtor.

FUTURONICS CORPORATION,
Debtor-Appellee-Cross Appellant

v.

ARUTT, NACHAMIE & BENJAMIN and
ARUTT, NACHAMIE, BENJAMIN, LAZAR
& KIRSCHNER, P.C.
Appellants-Cross-Appellees

ISRAEL & RALEY,
Appellant-Cross-Appellee

Before: OAKES and MESKILL, *Circuit Judges,* and SAND, *District Judge.**

Appeal and cross-appeal from judgments entered in the United States District Court for the Southern District of New York, Duffy, J., denying any compensation to general counsel and special counsel for debtor-in-possession in a Chapter XI proceeding based upon counsels' violations of Bankruptcy Rules 215 and 219 and breaches of fiduciary obligations to bankruptcy court.

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*Honorable Leonard B. Sand, United States District Judge for the Southern District of New York, sitting by designation.

Affirmed.

ALEX SPIZZ, New York, New York
Arutt, Nachamie, Benjamin,
Lipkin & Kirschner, P.C.,
New York, New York
Of Counsel for Appellants

MORTIMOR S. GORDON,
New York, New York
Joseph Chase, James Lehrburger,
Hall, Dickler, Lawler, Kent &
Howley, New York, New York
Of Counsel for Appellant
Israel & Raley

GARY L. BLUM, New York, N.Y.
Daniel A. Zimmerman, Finley,
Wagner, Heine, Underberg
& Casey, New York, New York
Of Counsel, for Appellee

MESKILL, CIRCUIT JUDGE:

Once again we are faced with the unsavory task of reviewing the propriety of an order imposing sanctions upon counsel for a party in a bankruptcy proceeding based upon attorney misconduct. Two law firms, Arutt, Nachamie & Benjamin (the "Arutt firm") and Israel & Raley & (the "Israel firm"),[1] which represented the debtor-in possession, Futuronics Corporation (Futuronics), in a proceeding under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§ 701-99 (1976), appeal from judgments entered

[1]At the time of the Israel firm's appointment, Mr. Raley was an associate of Mr. Israel. Subsequently Mr. Raley became a partner in the two-man firm.

in the United States District Court for the Southern District of New York, Duffy, J., denying the Arutt and Israel firms compensation for any services performed as general counsel and special counsel for the debtor-in-possession and ordering the return to Futuronics of fees which had been paid with interest accruing from July 15, 1980. Judge Duffy's decision affirmed the order of the bankruptcy court, Lesser, J., except insofar as it had awarded the firms any compensation. The district court determined that Judge Lesser had abused his discretion in allowing the appellants any fees for their professional services in light of the two firms' violations of Bankruptcy Rules 215[2] and 219[3] and breaches of their fiduciary obliga-

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[2]Rule 215 provides in pertinent part:

(a) Conditions of Employment of Attorneys and Accountants

> No attorney or accountant for the trustee or receiver shall be employed except upon order of the court. The order shall be made only upon application of the trustee or receiver, stating the specific facts showing the necessity for such employment, the name of the attorney or accountant, the reasons for his selection, the professional services he is to render, and to the best of the applicant's knowledge all of the attorney's or accountant's connections with the bankrupt, the creditors or any other party in interest and their respective attorneys and accountants. If the attorney or accountant represents or holds no interest adverse to the estate in the matters upon which he is to be engaged and his employment is in the best interest of the estate, the court may authorize his employment. Notwithstanding the foregoing sentence, the court may authorize the employment of an attorney or account who has been employed by the bankrupt when such employment is in the best interest of the estate. The employment of any attorney or accountant shall be only for the purposes specified in the order, but the court may authorize a general retainer of an attorney when necessity therefor is shown.

(b) Employment of attorney or Accountant with Adverse Interest

(footnote 2 continued and footnote 3)

> If without disclosure any attorney or accountant employed by the trustee or receiver shall represent or hold, or shall have represented or held, any interest adverse to the estate in any matter upon which he is so employed, the court may deny the allowance of any compensation to such attorney or accountant, or the reimbursement of his expenses, or both, and may also deny any allowance to the trustee or receiver if it shall appear that he failed to make diligent inquiry into the connections of such attorney or accountant.

(f) Services Rendered by Member or Associate of Firm of Attorneys or Accountants

> If, under this rule, a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed on behalf of a professional partnership or corporation, any member or regular associate of the firm may act for the attorney or accountant so employed, without further order of the court, and his services may be compensated as services of the attorney or accountant in accordance with Rule 219.

[3]Rule 219 provides in pertinent part:

(a) Application for Compensation or Reimbursement

> A person seeking compensation for services or reimbursement of necessary expenses, from the estate shall file with the court an application setting forth a detailed statement of (1) the services rendered and expenses incurred, and (2) the amounts requested. An application for compensation shall include a statement by the applicant as to what payments have therefore been made or promised to him for services rendered or to be rendered in any capacity whatsoever in connection with the case, the source of the compensation so paid or promised, whether any compensation he has previously received has been shared and whether an agreement or understanding exists between the applicant and any other person for the sharing of compensation received

(footnote 3 continued)

or to be received for services rendered in or in connection with the case, and the particulars of any such sharing of compensation or agreement or understanding therefor, except that the details of any agreement by the applicant for the sharing of his compensation as a member or regular associate of a firm of lawyers or accounts shall not be required. The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other person on his behalf.

(b) Disclosure of Compensation Paid or Promised to Attorney for Bankrupt

Every attorney for a bankrupt, whether or not be applies for compensation, shall file with the court on or before the first date set for the first meeting of creditors, or at such other time as the court may direct, a statement setting forth compensation paid or promised him for the services rendered or to be rendered in connection with the case, the source of the compensation so paid or promised, and whether the attorney has shared or agreed to share such compensation with any other person. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of his compensation with a member or regular associate of his law firm shall not be required.

. . .

(d) Restriction on Sharing of Compensation

Except as herein provided a person rendering services in a bankruptcy case or in connection with such a case shall not in any form or guise share or agree to share the compensation paid or allowed him from the estate for such services with any other person, nor shall he share or agree to share in the compensation of any other person rendering services in a case under the Act or in connection with such a case. This rule does not prohibit an attorney or accountant from sharing his compensation as trustee, receiver, attorney, or accountant with a

tions as officers of the court. For the reasons set forth below, we affirm.[4]

BACKGROUND

In January 1975, Futuronics filed its petition in bankruptcy under Chapter XI.[5] On the same day an order was entered authorizing the appointment of the Arutt firm as counsel for the debtor under a general retainer. The Arutt firm served as counsel for the debtor until September 1977. The action was originally assigned to Bankruptcy Judge Asa Herzog. Upon Judge Herzog's retirement, the action was reassigned to Bankruptcy Judge Stanley T. Lesser.

(footnote 3 continued)

> member or regular associate of his firm, or from sharing in the compensation received by his firm or by any other member or regular associate thereof, and does not prohibit an attorney for a bankrupt or for a petitioning creditor from sharing his compensation for services rendered with any other attorney contributing thereto. If a person violates this subdivision, the court may deny him compensation, may hold invalid any transaction subject to examination under Rule 220 to which he is a party, or may enter such other order as may be appropriate.

[4]Additionally, Futuronics cross-appeals from the judgments entered against the appellants, contending that they failed to award pre-judgment interest, failed to hold the law firms jointly and severally liable for the approximately $60,000 in unauthorized payments made by the Israel firm to the Arutt firm, failed to hold a professional corporation formed by members of the Arutt firm liable as a successor-in-interest, and failed to hold Fred Israel individually liable for the liability of the Israel firm. We find no merit in the foregoing contentions. While we agree that Judge Lesser abused his discretion in awarding the appellants any compensation, we find no such error in connection with the judgments entered.

[5]Since the petition was filed prior to October 1, 1979, the effective date of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101 *et seq.* (Sup. III 1979), the Bankruptcy Act of 1898 as amended, 11 U.S.C. § 1 *et seq.* (1976), applies in this case.

The Arutt firm quickly discovered that Futuronics' financial ill health in 1975 was largely attributable to trouble it had been experiencing with a series of substantial government contracts. Thus, the firm decided that special counsel should be retained who possessed the requisite expertise to handle complex government contract litigation. At the suggestion of Albert Blanck, the president of Futuronics, th Israel firm was contacted. The Israel firm was appointed as special counsel for the debtor by an order of Bankruptcy Judge Herzog dated March 11, 1975.[6] The order purported to fix the compensation to be given the Israel firm; it incorporated by reference an affidavit of Mr. Israel which listed a $15,000 retainer, various contingency fees for government contracts and specific hourly rates for Mr. Israel and Mr. Raley. Although a creditors' committee and its counsel had already been selected, the March 11 order was entered *ex parte.*[7]

The Israel firm succeeded in obtaining a settlement stipulation in January 1979 from the government, subject to the approval of the Bankruptcy Court, which provided that "(1) the Government would pay Futuronics $4,650,000; (2) the Government would withdraw its $8,700,000 claim in the Futuronics' Chapter XI case; and (3) portions of filed and unfiled claims by subcontractors of Futuronics would be paid directly by the Government,

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[6]There is confusion in the record as to whether the order was entered on March 10 or 11. Since the parties and courts below have consistently referred to the "March 11 order," we have also done so to avoid confusion.

[7]Bankruptcy Rule 11-24(a)(7) requires that all creditors or the creditors committee be given a ten-day notice of a hearing on an application for allowances by an attorney. Judge Lesser determined that Judge Herzog must have left the fee provisions undisturbed through an oversight. A. 16-17.

relieving Futuronics of responsibility therefor, as if the prime contracts in question had been terminated for the convenience of the Government." A. 8-9. Judge Lesser approved the settlement after a hearing held in February 1979. Judge Lesser lauded the Israel firm for its work and noted in his opinion that the settlement would enable "the debtor . . . to propose a plan paying a significant amount, possibly even 100%, to general creditors." A.2.

Shortly after approval of the settlement of the government contract claims, the Israel firm submitted proposed orders seeking to have the bankruptcy court fix its compensation in accordance with the schedule incorporated by reference in Judge Herzog's order. Judge Lesser refused to sign the orders, reaffirming his previously expressed position that he was not bound by Judge Herzog's March 11 order. Instead, Judge Lesser on March 21 1979 directed the Israel firm to seek allowances for compensation in a manner consistent with Bankruptcy Rule 219. In an affidavit sworn to April 9, 1979, the Israel firm presented a detailed "Statement of Services Rendered by Special Counsel." A. 10 The affidavit disclosed to the court for the first time that the Israel firm had paid the Arutt firm approximately $60,000 in fees in connection with the government contract litigation. Futuronics' present counsel, the Finley firm,[8] seized upon this disclosure and moved on behalf of Futuronics that all compensation to the Arutt and Israel firms be denied based upon the apparent fee-sharing arrangement that had been entered into between the firms in violation of Bankruptcy Rule 219(d). Judge Lesser stated: "What the Court had believed was to be a proceeding to assess the reasonable value of fees to be paid to the Israel firm for a job well done, and the binding

[8]The Arutt firm was replaced in September 1977 by Schwartz & Sachs, P.C., a firm composed of former members of the Arutt firm. In October 1978, Futuronics retained a different firm, Finley, Kumble, Heine & Underberg (the Finley firm), which had no connection to its predecessors.

effect, if any, of Judge Herzog's March 11, 1975 order, took a radically different turn." A. 11.

After a full hearing, Judge Lesser determined that any work performed by the Arutt firm with respect to the government contract litigation had been done without court approval and thus in direct violation of Rule 215(a). Furthermore, Judge Lesser noted that the proposed order submitted in March 1975 for the appointment of the Israel firm as special counsel "did not contain the affirmation of Blanck as president of Futuronics"; "did not reveal the connections between the Israel and Arutt firms"; and falsely stated that "no prior application for the relief sought" had been made. A. 17. Judge Lesser discovered in the course of the hearings that contrary to the statement contained in the application for the March 11 order a prior application had indeed been presented to and rejected by Judge Herzog in February 1975. The previous application had included an affidavit which Judge Lesser determined embraced "a bald fee-splitting agreement, [which had been] foisted on the Israel firm by the Arutt firm, but accepted by the Israel firm with full knowledge of its implications." A. 12. Samuel Arutt of the Arutt firm conceded below that Judge Herzog had rejected the proposed February order "because of the 1/3-2/3" Fee-sharing arrangement contained in it[9] Judge Lesser discovered that after Judge Herzog had rejected the initial application, another was submitted which deleted the objectionable language concerning fee sharing. The bankruptcy judge determined that the parties decided

[9]Additionally, the affidavit of Mr. Israel which was submitted with the proposed February order stated: "Based on the services agreed to be rendered by [the Arutt firm], we have agreed to distribute fees received by us on a basis of two-thirds to ourselves and one-third to [the Arutt firm]." A. 12.

nevertheless to maintain their fee-sharing arrangement as evidenced by a letter dated March 3, 1975, without disclosing the agreement to the court. Thus, Judge Lesser concluded that Judge Herzog had signed the March 11 order without knowledge of the underlying agreement that had been entered into between the Arutt and Israel firms.

The record reveals that between March 1976 and April 1977, the Israel firm received approximately $190,000 in interim advances,[10] and that between May 1976 and May 1977 the Israel firm paid the Arutt firm approximately $60,000 or nearly one-third of its receipts. Judge Lesser noted that the Israel firm applied for interim compensation from the court on "perhaps a dozen occasions" and that each time "the Arutt firm participated in and urged the approval" of the applications. A. 14. On one occasion in 1977, Judge Lesser explained to the parties that he was denying interim alowances because the Israel firm had been paid fully up to date. The two law firms responded only with the contention that Judge Lesser was bound to the terms of the March 11 order that provided for interim allowances. The parties never once disclosed to the court that the Israel firm's financial hardship resulted from its payment of one-third of its interim advances to the Arutt firm, and never informed the court of the retainer agreement between the two firms. Judge Lesser stated in his opinion:

> It is inexplicable, and totally inconsistent with the Israel firm's present position that it never

[10]Advance payments continued up until October 1978. The payments made to the Israel firm totalled $218,380.

> doubted the propriety of its arrangement with the Arutt firm, that neither Mr. Israel nor Mr. Raley disclosed to the Court the precipitating cause of its financial hardship in the case, to wit, that it had paid the Arutt firm approximately one-third of the funds that had been received from Futuronics.

A. 15. Judge Lesser concluded that the Arutt and Israel firms had entered into an illicit fee-sharing arrangement in violation of Bankruptcy Rule 219(d). A. 24.

Judge Lesser noted his authority to withhold compensation entirely, a.25-26, but chose to limit the sanctions against the firms. He directed the Arutt firm to return to Futuronics the $60,000 in unauthorized fees received from the Israel firm and to reduce the "reasonable compensation" that otherwise would be allowed to the Israel firm by approximately $190,000.[11] The Israel firm was allowed $850,000 in fees (which included a $200,000 "bonus") less the $218,380 already paid, or $631,620. the Arutt firm was allowed $36,635 as compensation for 470 hours of professional services performed on behalf of Futuronics, less the $10,000 retainer already paid, or $26,635. A. 27-32.

The parties appealed to the district court pursuant to § 39(c) of the Act, 11 U.S.C. § 67(c)(1976). Judge Duffy affirmed the bankruptcy court's decision to the extent that it denied compensation to the Israel and Arutt firms but reversed insofar as the order granted either of the firms any compensation. He determined that the bankruptcy court had abused its discretion in allowing any fees to the law firms in view of the serious nature of the attorneys' misconduct.

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[11] Judge Lesser determined that he was not bound by the compensation provisions contained in Judge Herzog's March 11 order, citing *In re Texlon Corp.*, 596 F.2d 1092 (2d Cir. 1979). A. 35. We need not address that issue in light of our decision to uphold the total denial of compensation in this case.

Judge Duffy noted that the Israel and Arutt firms had engaged in "a fee splitting arrangement in flagrant disregard of the Bankruptcy Rules"; had "intentionally kept the court in the dark about this arrangement for four years despite the numerous opportunities" to disclose the agreement; and had only revealed the illicit agreement after the court had requested a statement of services. Dist. Ct. op. at 25. He opined that had the bankruptcy court not requested the statement of services and had instead deferred to the contingency fee provisions contained in Judge Herzog's March 11 order, "the parties would never revealed the fee splitting arrangement." *Id*, at 26. Judge Duffy additionally noted that "once faced with this serious situation, both firms pled ignorance of the Bankruptcy Rules and attempted to place the blame" upon the debtor. Judge Duffy decided that the record belied the law firms' contentions of ignorance.

The district court concluded that the conduct of the two law firms "was totally unprofessional and in breach of their respective duties as fiduciaries and officers of the court." *Id.* Judge Duffy stated that "the conduct of both firms evinces 'a total pattern of conduct which betrays a callous disregard of the professional obligations undertaken in . . . a bankruptcy [proceeding].' " *Id.* (quoting *In re Arlan's Department Stores, Inc.*, 615 F.2d 925, 943 (2d Cir. 1979). the district court concluded that under the circumstances of the case, "a Judge would indeed be remiss if he were to permit a law firm guilty of such conduct to be compensated." *Id.*

DISCUSSION

The Rule 215 Violations

Bankruptcy Rule 215, as made applicable to Chapter XI proceedings by Rule 11-22, provides that no attorney shall be employed by the debtor except upon order of the bankruptcy court, and mandates that prospective counsel

disclose all of his "connections with the [debtor], the creditors, or any other party in interest, and their respective attorneys and accounts." In *In re Rogers-Pyatt Shellac Co.*, 51 F.2d 988, 992 (2d Cir. 1931), this Court stated that lawyers "who seek appointment as counsel for an officer of the court owe the duty of complete disclosure of all facts bearing upon their eligibility for such appointment . . . . If the rule is to have vitality and the evils against which it is aimed are to be eliminated, it should be enforced literally." Indeed, it has long been the practice in this Circuit to deny compensation to counsel who fail to comply with the disclosure provisions contained in Rule 215 (superseding General Order 44). See *In re Arlan's Department Stores, Inc., supra; In re Progress Lektro Shave Corp.*, 117 F.2d 602 (2d Cir. 1941); *In re Rogers-Pyatt Shellac Co., supra; In re H.L. Stratton, Inc.*, 51 F.2d 984 (2d cir. 1931), *cert. denied*, 284 U.S. 682 (1932); *In re Eureka Upholstering Co.*, 48 F.2d 95 (2d Cir. 1931). In *Eureka*, this Court held that a technical noncompliance with these disclosure requirements warranted a total denial of compensation. While this rigorous interpretation of the rule was somewhat relaxed in *Connelly v. Hancock, Dorr Ryan & Shove*, 195 F.2d 864 (2d Cir. 1952), in that case the relevant facts were "generally disclosed to the judge" and the record indicated that "the facts were known by the judge at the time of appointment." 195 F.2d at 868. In the case at bar, however, the bankruptcy court was not informed of the retainer agreement between the Arutt and Israel firms until four years after the entry of the order approving the Israel firm's retention. From the beginning, a cloud hung over the appointment of th Israel firm. Rule 215 expressly required the Israel firm to disclose all "connections" it had with the attorneys for the debtor. This it failed to do. With respect to the Arutt firm, although the firm was appointed pursuant to Rule 215 by the bankruptcy court in January 1975 to act as general counsel, the firm never received the required court approval to perform any of the work in the government contract litigation. In-

deed the Arutt firm exhibited a total and callous disregard for the disclosure requirements of Rule 215 by actually submitting the Israel firm's application without disclosing its arrangement with the latter.

The Rule 219 Violations

The law firms not only violated the mandatory disclosure provisions contained in Rule 215, but also directly violated the statutory proscription in Rule 219 against fee-splitting arrangements. Judge Lesser determined that the Israel firm "shared $60,000 of its compensation with the Arutt firm. The former was the 'sharor', the latter was the 'sharee." A. 23. He concluded that the agreement violated Bankruptcy Rule 219(d). We believe that the record amply supports the finding of the bankruptcy court that the clandestine agreement entered into between the Arutt and Israel firms in March 1975 constituted an unlawful fee-splitting arrangement in violation of Rule 219.

Rule 219(a), as made applicable to Chapter XI proceedings by Rule 11-31, requires attorneys seeking compensation from the court to disclose "whether an agreement or understanding exists between the applicant and any other person for the sharing of compensation received or to be received for services rendered . . . in connection with the case . . . ." Subdivision (d) of the rule constitutes an outright prohibition of the type of arrangement entered into between the Arutt and Israel firms and further provides that "[i]f a person violates this subdivision, the court may deny him compensation, may hold invalid any transaction subject to examination under Rule 220 to which he is a party or may enter such other order as may be appropriate."[12]

[12]Rule 219 restated the long-standing prohibition against illicit fee-sharing arrangements. The rule also eliminated the exemption concerning forwarding fees formerly countenanced under section 62

The Arutt and Israel firms' violations of subdivisions (a) and (d) of Rule 219 provide an independent basis for denying compensation. Fee-splitting arrangements have long been acknowledge as anathematic enterprises because of their natural tendency to cause an attorney to inflate his fees in order to offset the diminution in compensation caused by the agreement. *See Weil v. Neary,* 278 U.S. 160 (1929); *Albers v. Dickinson,* 127 F.2d 957 (8th Cir. 1942); *Gochenour v. Cleveland Terminals Building Co.,* 142 F.2d 991 (6th Cir.), *cert. denied,* 323 U.S. 767 (1944); *In re Consolidated Factors Corp.,* 59 F.2d 193 (2d Cir. 1932). *See generally* 12 *Collier, supra* at 2-203 to 2-221. Moreover, they "also subject [ ] the officer or attorney sharing fees to outside influences and may result in a transfer of control to persons who, at best, have a distinctly lesser degree of public responsibilities." 12 *Collier, supra,* ¶ 219.07 at 2-220.

Section 62(d) of the Act, 11 U.S.C. § 102(d) (1967), formerly mandated that if an attorney "has, in any form or guise, shared or agreed to share his compensation or in the compensation of any other person contrary to the provisions of subdivision (c) of this section, *the court shall withhold all compensation* from such petitioner." (Emphasis supplied.) We do not interpret Rule 219(d), which supersedes the latter provision, as contemplating the imposition of less severe sanctions; rather, the rule was intended to make available *additional* sanctions such as removal from office or dismissal from employment. *See Advisory Committee Note to Rule 219.* In any event we are convinced that the violation of the bankruptcy rules' prohibition against illicit fee-sharing involved in this case warranted no less than a total denial of compensation.

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of the Act. The latter change was made so that the rule comported with Canon 34 of the Canons of Professional Ethics and Disciplinary Rule 2-107 of the Code of Professional Responsibility. *See* Advisory Committee Note to Rule 219; 12 *Collier, supra,* ¶¶ 219.01 to 219.03.

The Breaches of Fiduciary Obligations Owed to the Bankruptcy Court

We emphasized in *Arlan's* that the duty of counsel for the debtor in a bankruptcy proceeding to disclose fully to the court all connections that may exist between counsel and the debtor, the creditors, any party in interest, and their respective attorneys arises not solely by reason of the bankruptcy rules, but also is founded upon "the fiduciary obligation owed by counsel for the debtor to the bankruptcy court." 615 F.2d at 937; *accord, In re The Bohack Corp.*, 607 F.2d 258 (2d Cir. 1979). *See generally Brown v. Gerdes,* 321 U.S. 178; 182 (1944); *Woods v. City Bank Co.*, 312 U.S. 262, 269 (1941); *Finn v. Childs Co.*, 181 F.2d 431, 441 (2d Cir. 1950).

Both the Arutt firm and the Israel firm flagrantly breached their fiduciary obligations to the bankruptcy court. This is not a case of technical noncompliance as the parties would have us characterize their conduct; rather, as Judge Lesser determined below, "[t]he entire process pertaining to the [appointment of the Israel firm under] the March 11, 1975 order either was calculated to deceive Judge Herzog or was rife with deficiencies which undercut its very existence." A. 18. The record clearly established that the proposed order submitted to Judge Herzog in March 1975 contained a false statement to the effect that no prior application for the relief sought had been made, when in fact, such an application had been made and had been rejected because it had embraced an apparent fee-splitting arrangement between the Arutt and Israel firms. Within one month of Judge Herzog's refusal to approve the retention of the Israel firm in the face of the apparent fee-splitting arrangement with the Arutt firm, the appellants deviously deleted the unseemly portions from their application, covertly agreed to maintain their agreement in any event, and resubmitted their proposed order devoid of any reference to their prior attempt or their con-

tinued illicit contract. Moreover it is undisputed that, without the requisite authorization of the court the Israel firm paid and the Arutt firm received approximately $60,000 in fees pursuant to the undisclosed retainer agreement entered into between the parties. Despite numerous opportunities to disclose the arrangement early in the proceeding to Judge Lesser the parties chose surreptitiously to continue their fee-splitting arrangement. Their lack of fidelity was manifested time and again before the court, on each occasion compounding the gravity of their transgression. We find outrageous the Arutt and Israel firms' failure to disclose their retainer agreement on the occasion described by Judge Lesser A. 14-15, in which they importuned the bankruptcy court for an interim advance, stated that the Israel firm was suffering financial hardship, but nevertheless neglected to inform the court that approximately one-third of the advances already paid to the Israel firm had been handed over to the Arutt firm. Not until Judge Lesser refused to execute proposed compensation orders and requested submissions from the parties in compliance with Rule 219 did the unlawful fee-sharing arrangement come to light. The nadir was finally reached when, upon the revelation of their scheme, they cavalierly professed ignorance of the bankruptcy rules and characterized their actions as amounting to "technical breaches" at best.

The Sanctions

In *Arlan's,* an action strikingly similar to the case at bar, this Court held that a district court's determination that violations of Bankruptcy Rule 215 and breaches of fiduciary obligations by the general counsel and special counsel for the debtor-in-possession in a Chapter IX preceeding constituted sufficient grounds to warrant a total denial of compensation to the misfeasors. The appellants attempt to distinguish the *Arlan's* case on the ground that there the Chapter XI proceeding was a dismal

failure, whereas in the case at bar, the bankruptcy proceeding was a great success. The appellants argue that none of the evils that otherwise might be attributable to fee sharing or their other acts manifested themselves here and that, therefore, the illicit conduct of the law firms should be excused. But it is well settled that "such agreements are not less reprehensible because in a particular case they may not have resulted in any clearly discernible harm to the estate or its creditors. It is the *potential* danger alone that makes them obnoxious." 3A *Collier, supra,* ¶ 62.37 at 1636 (emphasis in original). Additionally, Judge Carter did not decide whether the challenged agreement in the *Arlan's* case constituted an illicit fee-sharing agreement, but held that in any event the "totality of Ballon's failure of full disclosure [left] no other recourse" but to deny compensation. 462 F.Supp. at 1265. Thus, unlike the case at bar, the lower court in *Arlan's* did not make an explicit finding that the law firms seeking compensation had engaged in a clandestine fee-splitting arrangement in direct violation of Rule 219. Yet, this Court found that the total denial of compensation to the attorneys in that case was "appropriate." 615 F.2d at 944.

We conclude that Judge Duffy correctly ruled that Judge Lesser abused his discretion in awarding any compensation to the attorneys in this case. As in *Arlan's,* "we deal in this case not with isolated instances of oversight but with a total pattern of conduct which betrays a callous disregard of the professional obligations undertaken in these bankruptcy proceedings." 615 F.2d at 943. We agree with his holding "that given the conduct involved herein . . . the only appropriate sanction to be imposed" is to deny all compensation Dist. Ct. op. at 30 n.3. Whatever discretion a bankruptcy court judge may have to fashion an appropriate sanction for an attorney's violation of the bankruptcy rules and breaches of his fiduciary obligations to the court, given the egregiousness of the conduct here, it was an abuse of that discretion to permit

the appellants to retain any of the fees they had received, let alone to allow any further compensation.[13]

Affirmed.

[13]In light of our holding, we find it unnecessary to review the correctness of Judge Lesser's compensation formula.

FUTURONICS CORP. v. ARUTT
NACHAMIE & BENJAMIN, *et al.* Filed
No. 80-5032, *et seq.* Jul 02 1981

OAKES, *Circuit Judge* (concurring in part and dissenting in part):

I do not disagree with the substance of the majority opinion. What the law firms did here was not only stupid, it was reprehensible. They entered into a fee-splitting arrangement contrary to the Bankruptcy Rules, behind the court's back, and, despite numerous occasions on which they could have disclosed the arrangement, they carefully kept it concealed.

Nor do I quarrel with the disposition as to the Arutt firm; as general counsel for the debtor, they benefited monetarily from the fee-splitting arrangement. Presumably Arutt established the arrangement because it sent the debtor's business problems with the Government to the Israel firm; Arutt treated its split as forwarding fees, which used to be charged years ago by many law firms with hardly a second thought as to the ethical implications. But in today's world, Arutt should have known better. They were properly required by the court to return to Futuronics the unauthorized fees that they received, and the further requirement that they forego any and all compensation whatsoever certainly cannot be labeled an abuse of discretion. Indeed, I fully agree with the majority on this point.

But I would treat the Israel firm somewhat differently. Even though their conduct was probably equally egregious on the scale of legal ethics, they nevertheless were performing substantial services for the bankrupt and were foregoing fees earned, rather than pocketing additional fees in order to pay Arutt. Israel was a two-man firm, so expert in their field that they recovered $4.650 million for the debtor and induced the Government

to withdraw an $8 million-plus claim against Futuronics and relieve Futuronics of potential liabilities to subcontractors. All of this work by Israel enabled Futuronics to propose a plan to pay its creditors 100 cents on the dollar. In fact, Israel did its job so well that the bankruptcy judge was willing to allow them $850,000 in fees, which included a $210,000 bonus for the four years of work that they performed. The actual penalty imposed upon them by the bankruptcy judge was $190,000.

I am a believer in the principle that the punishment should fit the crime, that our time-honored tradition of fairness and justice requires court-imposed sanctions to be proportional to the wrong committed. I explained this point of view at no little length in a dissent in *Carmona v. Ward,* 576 F.2d 405, 417 (2d Cir. 1978), *cert denied,* 439 U.S. 1091 (1979), and I believe that the same principle should hold true on the civil side. I realize that my proportionality view was in a real sense rejected by the Supreme Court in *Rummel v. Estelle,* 445 U.S. 263 (1980), but that was in the constitutional context of penalties set by a legislature. I view *Rummel v. Estelle* as resting in large part upon a concept of deep judicial deference to legislative penalty-setting, at least where capital punishment is not involved.[1]

Here, however, we are dealing strictly with judicial discretion. Bankruptcy Rule 219(d) provides that if a person violates the restriction on fee sharing, "the court *may* deny him compensation" or "*may* enter such other order as may be appropriate." (Emphasis added.) In this regard it is interesting to note that Rule 219(d), which harmonizes bankruptcy practices with Canon 34 of the Canons of Professional Ethics and Disciplinary Rule 2-107 of the Code of Professional Responsibility, displaces section 62(c) of

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[1]See Nesson, *Rationality, Presumptions, and Judicial Comment: A Response to Professor Allen,* 94 Harv. L. Rev. 1574, 1580-81 (1981).

the Bankruptcy Act, which permitted the sharing of compensation by the working attorney with the forwarding attorney. Although the rules have been in effect since 1973, and the Israel firm cannot disavow knowledge of them, nevertheless the practice now condemned is one that for many years was condoned.

I do think that Bankruptcy Judge Lesser leaned over backwards to reward the Israel firm for its concededly extensive and successful work. But I have reluctantly concluded that the district judge and the majority have gone just as far the other way in leaning over to punish the Israel firm for their wrongful acts of paying some $60,000 in forwarding fees to the Arutt firm and not disclosing their arrangement to the bankruptcy court. In this regard I would wholly distinguish this case from the one particularly relied upon by Judge Duffy, *In re Arlan's Department Stores, Inc.*, 615 F.2d 925 (2d Cir. 1979). Here the only arrangement not disclosed to the court was the $60,000 in "forwarding fees." In *Arlan's* there was no disclosure of a wide variety of fees and arrangements—a $125,000 retainer, *Id.* at 934-37; a $5,000 payment, *Id.* at 937-38; a $25,000 retainer, *Id.* at 938-39; a $40,000 payment, *Id.* at 941-42; and a $21,088.50 reimbursement for expenses, *id.* at 942. In *Arlan's* the payment of the initial retainer of $125,000 left the debtor without cash to operate, *Id.* at 935-36, and this alone was improper. In short, in *Arlan's* there was "a total pattern of conduct which betray[ed] a callous disregard of the professional obligations undertaken in these bankruptcy proceedings." *Id.* at 943. Here, although there was a serious breach of duty, so far as appears otherwise the Israel efforts were totally dedicated to the best interests of the debtor and its creditors.

I would certainly not make a rule of law depend upon the outcome to the bankrupt. In other words, I agree with the majority that the evil to the public interest is in the

tendencies, first, for the fee applicant to claim a compensation high enough to make his own share in it worthwhile and, second, for the debtor's counsel who receives a fee division not to object to the court regarding the extravagance of the applied for fees. At the same time, in the exercise of discretion to impose a penalty and on the basis of the principle that the punishment should fit the crime, it strikes me that to deprive the Israel firm of all compensation and to require them to return the sums already received is somewhat equivalent to chopping off an arm for stealing a basket of olives.

In calculating Israel's fees, Bankruptcy Judge Lesser began with the approximately 6,400 hours spent by the firm, fixed a "lodestar" rate of $100 per hour, and in the absence of the Rule 219 violation would have awarded them an additional $400,000 under the teachings of *City of Detroit v. Grinnell Corp.*, 560 F.2d 1093 (2d Cir. 1977). Judge Lesser reduced that $400,000 by $190,000, and against the $850,000 total of course credited the $218,380 (some $60,000 of which had gone to Arutt) previously received for services. This left the Israel firm with a net payment of $631,620.

I would mete out twenty lashes, neither chopping off the arm nor tapping the wrist. If the bankruptcy judge thought that $640,000 was a proper starting rate, I would award no bonus and cut the fee in half to $320,000, against which I would credit the $218,380 already paid. For a two-man firm, exercising high skills and hard effort, and spending between three and four years of time on a case which will probably culminate in the creditors getting 100 cents on the dollar, it would seem to me that a $320,000 punishment would better fit the crime. Others, I know, think differently and I would be the last to suggest that they are not reasonable men.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter
of
FUTURONICS CORPORATION
Debtor.

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79 Civ. 6305 (KTD)
OPINION & ORDER

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KEVIN THOMAS DUFFY, D.J.:

Attorneys are officers of the court and must conduct themselves accordingly. They are professionals and, as such, are to be held to a higher standard in the discharge of their duties in this regard. *Arlan's Department Stores, Inc.*, 615 F.2d 925 (2d Cir. 1979). This is especially true in the context of a Chapter XI proceeding where the debtor's counsel acts as a fiduciary. *Id.* at 932-33. The court must necessarily rely extensively upon the integrity of debtor's counsel in the handling and administration of a debtor's assets. However, the conduct involved in the case at bar exhibits a total disregard of an attorney's status as a court officer and a fiduciary. And, although the conduct to which I refer was limited to a few individuals, it acts to fuel the fires which, unfortunately, tend to char the entire profession.

This is an appeal from the decision of Stanley T. Lesser, Bankruptcy Judge, determining the allowances to be paid to the law firms of Arutt, Nachamie, Benjamin, Lipkin & Kirschner, P.C. and Israel & Raley. The salient facts are as follows.

In 1974, the Futuronics Corporation [hereinafter referred to as "Futuronics"] was engaged in the business of manufacturing military equipment for the United States Government. In December of 1974, the financial condition of Futuronics had deteriorated to the point where the corporation, through its President, Albert Blanck, began to explore the possibility of seeking protection from its creditors under the Bankruptcy Act. To this end, Mr. Blanck spoke with representatives of the law firm of Arutt, Nachamie & Benjamin [hereinafter referred to as "AN&B], an experienced bankruptcy firm. These talks progressed and it was ultimately determined that a filing under Chapter XI of the Bankruptcy Act was appropriate. The petition was prepared by AN&B and, on January 3,

1975, it was filed. Upon the filing, AN&B was appointed by the court as counsel for Futuronics. The action was originally assigned to Bankruptcy Judge Herzog. Upon his retirement from the bench, the case was assigned to Bankruptcy Judge Stanley T. Lesser.

Apparently, a large part of the debtor's potential assets hinged upon a number of government contracts for the production of military equipment. It was the debtor's position that these contracts had been wrongfully terminated by the government. By virtue of this wrongful termination, the debtor claimed entitlement to a substantial damage award.

In light of these government contracts, and the potential assets to be realized therefrom, Futuronics, again through the efforts of its President, Albert Blanck, sought to secure the services of a law firm versed in the area of government contracts to prosecute these claims. The search yielded the firm of Israel & Raley [hereinafter referred to as "I&R"]. On March 11, 1975, Judge Herzog signed an order permitting the retention of I&R as special counsel to Futuronics for the purpose of prosecuting these claims against the government.

The firm of AN&B continued to represent the debtor through most of 1977. In September of that year, the firm was replaced by the firm of Schwartz & Sachs, P.C., which was comprised of former members of the AN&B firm. Thereafter, in October, 1978, the Schwartz firm was itself replaced as debtor's counsel by the firm of Finley, Kumble, Wagner, Heine & Underberg [hereinafter referred to as "Finley Kumble"].

The essence of the dispute between the parties is what fees, if any, are collectable by AN&B and I&R for services rendered by them to the debtor while serving as its counsel and special counsel, respectively. More particularly, there are two questions presented herein. They are: what bind-

ing effect, if any is to be afforded the order of Judge Herzog, dated March 11, 1975, appointing I&R as special counsel to Futuronics and which, through the attached affidavit of Mr. Israel, incorporated a contingent fee arrangement; and whether the conduct of AN&B and I&R in securing the appointment of I&R as special counsel, the facts and circumstances surrounding their compensation and retainer agreements as well as the securing of court approved interim payments to I&R, were violative of the Bankruptcy Rules and warranted the reduction and/or denial of the requested compensation.

Judge Lesser initially found that Judge Herzog's March 11th order did not irrevocably commit the court with respect to the fact and manner of I&R's compensation. In addition, after conducting extensive hearings concerning the fees to be awarded AN&B and I&R, he concluded that both firms had breached their respective duties as fiduciaries of the debtor's estate, and as officers of the court, by failing to disclose an impermissible "fee splitting agreement." Judge Lesser also found that these breaches were violative of Rule 215 and 219 of the Bankruptcy Rules and were of sufficient magnitude to warrant the return to I&R of all fees shared between it and AN&B as well as a reduction in the fees collectable by I&R.

For the reasons stated below, I affirm that portion of Judge Lesser's opinion finding that the March 11, 1975 order of Judge Herzog was reviewable by Judge Lesser, and that the conduct of AN&B and I&R in connection with that order, as well as their continued failure to apprise the court of an otherwise impermissible fee arrangement, constituted violations of Rules 215 and 219 of the Bankruptcy Rules. However, I reverse that portion of Judge Lesser's opinion with respect to the amount of fees collectable by the firms and direct that both requests for compensation must be denied in their entirety.

Before addressing what finality attached to Judge Herzog's March 11th order it is necessary to set forth the facts leading up to the entry of that order. It is undisputed that the March 11th retention order was not the first order presented to Judge Herzog seeking retention of I&R as special counsel. An earlier proposed order of retention had been presented to Judge Herzog in February, 1975, and was rejected by him. This earlier proposed order, as well as the March 11th order, was not presented to Judge Herzog on notice to the Creditors Committee or its counsel. Thus, no objections to the proposed order were raised by the parties. Rather, Judge Herzog rejected the proposed order, *sua sponte*. Unfortunately, he did not state his reasons for doing so on the record. However, the extensive record below, with respect to the fees in issue, supplies more than sufficient evidence from which Judge Herzog's motives may be gleaned.

In January 1975, a retainer letter was executed by I&R and AN&B. The agreement provided, in pertinent part, that I&R would pay AN&B "one-third of all fees received for professional legal services and assistance agreed to be rendered by the firm of [AN&B] to the law offices of [I&R] in relation to the contract claims of Futuronics against the United States Government."

The retainer agreement was forwarded to AN&B for its signature as well as that of the debtor, Futuronics. Accompanying the agreement was the affidavit of Mr. Israel which was apparently attached as an exhibit to the proposed retention order rejected by Judge Herzog in February, 1975. The affidavit, a mirror of the retainer agreement, provided: "Based on the services agreed to be rendered by [AN&B], [I&R has] agreed to distribute fees received by us on a basis of two-thirds to ourselves [I&R] and one-third to [AN&B]."

Upon rejection of the February retention order, a revised retainer agreement, as well as a revised affidavit, were prepared by I&R and sent to AN&B. The new retainer agreement provided:

> In view of the fact that we will be looking to your law firm for legal services and assistance in connection with the matters we are undertaking under the agreement, and may be working through your firm with the creditors to try to effect an agreement with the United States, I would suggest that you prepare appropriate billings for your time and, at the conclusion of this matter, we could go to the Court and recommend to them how the fees are to be distributed. Please provide us with copies of your time records.

A new proposed order, and a revised affidavit, were submitted to Judge Herzog. In addition to omitting any reference to the new retainer agreement quoted above, the order provided that "no prior application" had been made for the relief requested therein. This order was signed by Judge Herzog and provided in pertinent part:

> ORDERED, that FUTURONICS COPORATION be and it hereby is authorized to retain the firm of FRED ISRAEL for the purposes set forth in the affidavit of Mr. Israel, which is annexed hereto and made part hereof. Compensation of Mr. Israel shall be in accord with Paragraphs 8 and 9 of Mr. Israel's affidavit.

The compensation provisions contained in the Israel affidavit provided:

> 8. That an advance against out-of-pocket expenses in the amount of $2,500.00 will be paid

to the Law Offices of Fred Israel from first available funds.

9. That in addition to the payment of all out-of-pocket expenses and the foregoing retainer, the Law Offices of Fred Israel will be paid fees for professional services rendered, according to the following schedule:

a. Contract No. F34601-70-C-3556, U.S. Air Force, Sacramento, California:

One-third of all progress payments released and paid to Debtor - hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Debtor.

b. Contract No. M00027-69-C-0045, U.S. Marine Corps:

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Debtor.

c. Contract No. DAAB05-71-C-3703, U.S. Army, ECOM:

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Debtor.

d. Contract No. DAAB07-74-C-0327, U.S. Army, ECOM:

Contract No. DAAB07-70-C-4417, U.S. Army, ECOM:

Contract No. DAAB05-73-C-1002, U.S. Army, ECOM:

Contract No. DAAB05-74-C-1300, U.S. Army, ECOM:

Contract No. F19628-74-C-0119, U.S. Air Force, Hanscom Field:

and

all other Contracts between Debtor and the United States Government:

One-third of all Progress Payments released and paid to Debtor – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Debtor.

Rule 215 of the Bankruptcy Rules concerns the retention of debtor's counsel and provides in pertinent part:

> (a) Conditions of Employment of Attorneys and Accountants. No attorney or accountant for the trustee or receiver shall be employed except upon order of the court. The order shall be made only upon application of the trustee or receiver, stating the specific facts showing the necessity for such employment, the name of the attorney or accountant, the reasons for his selection, the professional services he is to render, and to the best of the applicant's knowledge all of the attorney's or accountant's connections with the bankrupt, the creditors, or any other party in interest, and their respective attorneys and accountants. If the attorney or accountant represents or holds an interest adverse to the estate in the matters upon which he is to be engaged, and his employment is in the best interest of the estate, the court may

authorize his employment. . . . . The employment of any attorney or accountant shall be only for the purposes specified in the order but the court may authorize a general retainer of an attorney when necessity therefore is shown.

(b) Employment of Attorney or Accountant with Adverse Interest. If without disclosure any attorney or accountant employed by the trustee or receiver shall represent or hold, or shall have represented or held, any interest adverse to the estate in any matter upon which he is so employed, the court may deny the allowance of any compensation to such attorney or accountant, or the reimbursement of his expenses, or both, and may also deny any allowance to the trustee or receiver if it shall appear that he failed to make diligent inquiry into the connections of such attorney or accountant.

. . .

(f) Services Rendered by Member or Associate of Firm of Attorneys or Accountants. If, under this rule a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed on behalf of a professional partnership or corporation, any member or regular associate of the firm may act for the attorney or accountant so employed, without further order of the court, and his services may be compensated as serv-

ices of the attorney or accountant in accordance with Rule 219.

Rule 219, dealing with compensation, provides:

(a) Application for Compensation or Reimbursement. A person seeking compensation for services, or reimbursement of necessary expenses, from the estate shall file with the court an application setting forth a detailed statement of (1) the services rendered and expenses incurred, (2) the amounts requested. An application for compensation shall include a statement by the applicant as to what payments have theretofore been made or promised to him for services rendered or to be rendered in any capacity whatsoever in connection with the case, the source of the compensation so paid or promised, whether any compensation he has previously received has been shared and whether an agreement or understanding exists between the applicant and any other person for the sharing or compensation received or to be received for services rendered in or in connection with the case, and the particulars of any such sharing of compensation or agreement or understanding therefore, except that the details of any agreement by the applicant for the sharing of his compensation as a member or regular associate of a firm of lawyers or accountants shall not be required. The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other person on his behalf.

(b) Disclosure of Compensation Paid or Promised to Attorney for Bankrupt. Every attorney for a bankrupt, whether or not he applies for compensation, shall file with the court on or before the first date set for the first meeting of creditors, or at such other time as the court may direct, a statement setting forth the compensation paid or promised him for the services rendered or to be rendered in connection with the case, the source of the compensation so paid or promised, and whether the attorney has shared or agreed to share such compensation with any other person. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of his compensation with a member or regular associate of his law firm shall not be required.

. . .

(d) Restriction on Sharing of Compensation. Except as herein provided, a person rendering services in a bankruptcy case or in connection with such a case shall not in any form or guise share or agree to share the compensation paid or allowed him from the estate for such services with any other person, nor shall he share or agree to share in the compensation of any other person rendering services in a case under the Act or in connection with such a case. This rule does not prohibit an attorney or accountant from sharing his compensation as trustee, receiver, attorney, or accountant with a member or regular associate of his firm, or

> from sharing in the compensation received by his firm or by any other member or regular associate thereof, and does not prohibit an attorney for a bankrupt or for a petitioning creditor from sharing his compensation for services rendered with any other attorney contributing thereto. If a person violates this subdivision the court may deny him compensation, may hold invalid any transaction subject to examination under Rule 220 to which he is a party, or may enter such other order as may be appropriate.

The clear import of Rule 215 is that an attorney may be employed for the debtor *only* by order of the court. The rule is very specific with respect to the contents of an application for the rentention of counsel. It is sufficient to note that nowhere does Rule 215 provide that the application recite, or the retention order provide for, the rate or manner of compensation. Rather, it provides that compensation shall be in accordance with Rule 219 which, for its part, expressly prohibits the sharing of compensation among attorneys of different law firms except to reflect the actual contribution of services for which compensation is permitted.

Upon settlement of the disputes surrounding the government contracts in 1979 which, as previously mentioned, provided the lion's share of the debtor's estate, I&R applied to the court for compensation. The application requested that compensation be fixed in accordance with the contingent-fee provision contained in the Israel affidavit which was, ostensibly, irrevocably incorporated into Judge Herzog's order of March 11th.

The I&R application was initially opposed by the debtor, as well as by the Creditor's Committee, on the ground that a contingent-fee arrangement was inappropriate. The court, per Lesser, J., also expressed its reservations about the permissibility of such a fee arrangement in a Bankruptcy proceeding as it had previously done. Indeed, Judge Lesser had alerted the parties of his reservations about such a fee arrangement at least as early as April, 1976. To be sure, between April, 1976 and February, 1979, the court repeated its position with respect to the arrangement: that unless irrevocably committed as a matter of law to authorize payment to I&R in accordance with Judge Herzog's March order, the court intended to fix compensation in accordance with the standards and procedures prescribed in Rule 219.

At this juncture in the proceedings the only issue concerning I&R's fee, and the only objection lodged with respect thereto, concerned the contingent-fee provision. The question was whether Judge Herzog's order mandated that I&R recover a contingent fee or was the firm entitled only to a reasonable fee as computed under Rule 219.

Pursuant to Judge Lesser's direction, I&R submitted an affidavit entitled "Statement of Services Rendered by Special Counsel." This statement revealed, for the first time, that I&R had paid AN&B fees in excess of $60,000 – approximately 1/3 of the amount which had been paid to I&R as interim fees. These fees were allegedly for local work done by AN&B and were paid in response to periodic bills submitted to I&R by AN&B.

There is no question that I&R's previous payments to AN&B had never been revealed to the court prior to April, 1979. Nor had the court been apprised of the contents of the second retainer agreement between AN&B and I&R.

This is true despite the numerous hearings and conferences held in the instant proceeding and the serious questions raised by the court with respect to the contingent fee arrangement. Certainly there were numerous opportunities at which these payments and the retainer agreement could have properly been revealed.

At any rate, in light of these factual revelations in April, 1979, the debtor, through its new counsel, Finely Kumble, promptly moved to deny all compensation to both I&R and AN&B on the ground that the two law firms had engaged in fee splitting. The Creditor's Committee joined in the motion.

At this juncture in the proceeding, the question was no longer the permissibility of a contingent-fee arrangement but rather, whether the two law firms had engaged in fee splitting in violation of Rule 219. Of course, still underlying this issue was the question of what binding effect, if any, did Judge Herzog's March 11th order have with respect to the compensation of I&R. Stated differently, and as urged by AN&B and I&R, did the March 11th order of Judge Herzog vest certain rights in I&R as to the fact and manner of its compensation in the instant bankruptcy proceeding so as to preclude any subsequent modification thereof?

A review of the record, as well as the applicable law, reveals that the March 11th order did not create any rights in I&R, or AN&B, with respect either to the fact or manner of compensation. Moreover, the record more than supports Judge Lesser's finding of an impermissible fee splitting arrangement.

There is no dispute that AN&B was properly retained as counsel for the debtor. Indeed, Judge Lesser expressly found that AN&B was properly retained. And, despite

the failure of full disclosure in connection with the retention of I&R in violation of Rule 215, the fact of I&R's retention as special counsel was approved by Judge Lesser. The threshold question, therefore, is whether the retention application of I&R properly included a contingent-fee arrangement and whether the retention order, concededly prepared by I&R, properly incorporated this fee arrangement.

On appeal I&R urges, as it did below, that the fact and manner of their compensation vested at least as of February 16, 1979, and Judge Herzog's March 11th order "could not be modified or changed by Judge Lesser thereafter." More particularly, I&R urges that since on February 16, 1979, Judge Lesser approved the settlement agreement between the debtor and the United States Government with respect to the government contracts, yielding a recovery for the debtor of $17,000,000, I&R fully performed the mandate contained in Judge Herzog's order and was entitled to compensation as set forth therein.

It is true that a Bankruptcy Judge may reconsider his prior order, and upon reconsideration either vacate or modify it only if intervening rights will not be prejudiced. *See Wayne United Gas Co. v. Owens-Illinois Glass Co.*, 300 U.S. 131, 137-38 (1936); *In re Texlon Corp.*, 596 F.2d 1092, 1100-01 (2d Cir. 1979). However, to preclude reconsideration, the intervening rights must be clearly established and the resulting prejudice substantial. Indeed, in *Texlon,* the court found that while reconsideration is permissible only if, upon reconsideration, the court is able to reestablish the rights of the opposing party as they stood when the original order was signed, "it cannot be necessary for reconsideration that the court should be able to place a losing party in the same position as if there had been none." *Texlon, supra,* at 1101.

Thus, it is not every readjustment of positions which will bar reconsideration of a bankruptcy order. Rather, only when the readjustment is substantial will the intervening rights be so prejudiced as to bar reconsideration. Applying these principles to the case at bar, it is evident that reconsideration of Judge Herzog's order was well within the discretion of Judge Lesser and that his discretion was properly exercised.

Turning first to the question of the "vested rights" of I&R, despite the court's approval of the settlement of the government contracts, no right of compensation vested in I&R. It has long been an accepted principle that final compensation of counsel in a bankruptcy proceeding is subject to the approval of the Bankruptcy court. *See, e.g.*, Bankruptcy Rule 219; *The Official Creditor's Committee of Fox Markets, Inc.* v. *Ely*, 337 F.2d 461 (9th Cir. 1964), *cert. denied*, 380 U.S. 978 (1965).[1] And, when an application for fees is made, it is to be on notice to the creditors or, at the very least, to the Creditor's Committee, in order that any objections to the application may be lodged and to insure that the fee ultimately approved by the court is a reasonable one. *See* Bankruptcy Rule 11-24(a)(7).

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[1]The Advisory Committee's Note to Rule 219 is instructive in this regard. The Note provides that

> [t]he premise for including in these rules provisions governing the allowance of compensation to officers, attorneys, and accountants is that it is peculiarly a judicial responsibility to supervise the administration of estates and in particular to assure that allowances for compensation to those rendering services in connection therewith are fair but not excessive.

Clearly, in order that the spirit of Rule 219 is followed, it is crucial that the court be apprised of all fee arrangements that may exist between counsel. This, of course, was not done in the case at bar.

If, as I&R urges, the March 11th order of Judge Herzog was a self executing order with respect to attorney's fees, it was procedurally defective in that it was granted *ex parte*. Thus, the order, insofar as it purports to set compensation, was procedurally defective, *ab initio,* and could not vest any rights in I&R.[2]

In addition, the court, as early as April, 1976, and numerous times thereafter, expressed its reservations about a contingent-fee arrangement in a Chapter XI proceeding. Accordingly, I&R had actual notice of the court's reservations, as well as the court's position that unless otherwise bound by the March 11th order, it intended to fix I&R's compensation in accordance with the actual efforts expended by the firm. And yet, I&R continued to act as special counsel for the debtor from April, 1976 through February, 1979.

Under these circumstances it would be unreasonable for I&R to conclude that their contingent-fee arrangement was irrevocable. Indeed, the firm was certainly aware, or may be charged with knowledge, of the procedures to be followed in filing a fee application. Likewise, I&R was at least aware that its contingent-fee arrangement was subject to final approval by the court.

Even assuming that I&R's rights in the contingent-fee arrangement vested in February, 1979, the firm would not suffer substantial prejudice if compelled to accept a

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[2]In addition to the failure to provide notice to the other parties in the proceeding, the application for the retention was not prepared by the debtor, as required under Bankruptcy Rule 215, but rather was prepared by AN&B. No affidavit of a Futuronics representative was submitted in connection with the application. For this reason also, the retention agreement is not only procedurally defective but also suspect.

reasonable fee as computed under Rule 219. To be sure, the firm would be reimbursed for all legitimate expenses as well as reasonable compensation for all legal and paralegal efforts expended by it in connection with the settlement of the government contracts in issue.

It is crucial to remember that when Judge Lesser initially decided to reconsider the March 11th order of Judge Herzog, the sole question was whether I&R would be compensated on the basis of the contingent fee arrangement purportedly incorporated into that order or on a time-spent basis. There was no doubt, at least at that juncture, that I&R was entitled to receive a reasonable fee, including a reasonable profit, for its efforts on behalf of the debtor. Thus, the only prejudice to be suffered by I&R upon reconsideration and modification of Judge Herzog's order was that its fee was to be computed based upon the actual efforts expended for the debtor rather than as a percentage of the settlement fund. While this would tend to reduce I&R's fee given the size of the settlement fee vis-a-vis the actual time spent on the settlement by the firm, I&R was entitled to recover a reasonable fee. Accordingly, the court was able to reestablish the rights of the losing party without a major readjustment of I&R's position. *Texlon, supra,* 596 F.2d at 1101.

Furthermore, as noted above, I&R knew that this manner of compensation was preferred by the court at least as early as April, 1976. However, the bulk of services rendered to the debtor were rendered after April, 1976, and before any rights vested in February, 1979, with full knowledge of the court's position. Thus, it would appear that I&R assumed the risk that it would be compensated in accordance with Rule 219 rather than on a contingent-fee basis.

In addition, quite apart from the general doctrine of when a Bankruptcy court may reexamine a prior order, Rule 60(b) of the Federal Rules of Civil Procedure provides ample authority for the subsequent amendment of Judge Herzog's March 11th order. Rule 60(b), applicable in bankruptcy proceedings, *Texlon, supra,* 596 F.2d at 1100, provides that relief from an order is available where fraud, misrepresentation or misconduct was involved in the procurement of the order. And, while Rule 60(b) provides certain time limits within which a request for relief must be made, these time restrictions are inapplicable in a Bankruptcy proceeding. 7 Moore's Federal Practice. ¶60.18[7], at 213-14 (2d ed. 1979). Rather, the order may be reexamined at any time providing no intervening rights will be prejudiced. *Id.*

Finally, inasmuch as an order fixing compensation may be construed as an administrative order, it is subject to review at any time during the course of the bankruptcy proceeding if no intervening rights will be prejudiced.

Since it is evident that modification of Judge Herzog's order did not prejudice any intervening rights of I&R, if indeed such rights ever arose, either Rule 60(b) or the reviewability of administrative orders is sufficient to support the reexamination in issue.

I turn next to consider Judge Lesser's finding that AN&B and I&R violated Rules 215 and 219 of the Bankruptcy Rules.

Without unduly burdening an already tortured record, it is quite apparent that Judge Lesser's finding that AN&B and I&R violated the prohibition against fee splitting was more than supported by the credible evidence. Suffice it to say that despite the numerous applications of I&R for interim fees between December, 1976 through February,

1979, it never once disclosed, directly or indirectly, that it had paid approximately 1/3 of all these interim fees to AN&B. This is true despite the fact that at one conference called for the specific purpose of discussing I&R's contingent fee arrangement, the court expressed its opinion that the arrangement was improper and that I&R had already been compensated for substantially all the time it had expended in settlement of the government contracts. And yet, I&R never uttered one word to the effect that its time had not been compensated because of its payments to the AN&B firm of approximately 1/3 of all its fees.

Nor did AN&B, in urging the approval of the I&R interim fee applications, ever reveal, in sum or substance, that it had received compensation from I&R.

The sole question remaining is the sanctions to be imposed for these alleged violations. Judge Lesser although thoroughly offended by the conduct of AN&B and I&R, was favorably impressed by the fact that this was a successful proceeding. Indeed it appears likely that the debtor's plan when finally submitted, will provide that general creditors receive 100 percent of their claims.

In light of the successful nature of the instant bankruptcy proceeding, Judge Lesser found that both AN&B and I&R were entitled to a reasonable fee despite their abysmal conduct in connection therewith. He adjusted their fees as follows:

(1) AN&B was directed to return the $60,067.37 paid to them by I&R, with interest, to Futuronics. The firm was, however permitted to retain $36,635 for the 470 hours of professional services it rendered to Futuronics;

(2) Compensation for I&R for the 6,400 hours of professional services rendered to Futuronics was fixed at an

hourly rate of $100. In addition to this sum of $650,000, Judge Lesser, absent any Rule 219 problems, would have added a "bonus" of $400,000 for a grand total of $1,040,000. However, under the circumstances, Judge Lesser felt such a sizable bonus would be inappropriate and therefore reduced the bonus to $210,000. Thus, I&R's total fee for its work in the proceeding amounted to $850,000.

Under the circumstances, I find that Judge Lesser was far too lenient in fixing the fees for AN&B and I&R. We are dealing here with a case in which two law firms engaged in a fee splitting arrangement in flagrant disregard of the Bankruptcy Rules. In addition, both firms intentionally kept the court in the dark about this arrangement for four years despite the numerous opportunities at which point the arrangement could have been revealed. It was only when a detailed statement of services was requested by the court that the fee splitting was revealed. I have no doubt that the original contingent-fee arrangement been approved by Judge Lesser, the parties would never have revealed the fee splitting arrangement.

Moreover, once faced with this serious situation, both firms pled ignorance of the Bankruptcy Rules and attempted to place the blame for these violations upon the debtor's shoulders. I find these to be particularly ill chosen tactics given the abundant evidence contained in the record demonstrating AN&B and I&R's legal expertise which was flaunted in the retention applications.

I find, as did Judge Lesser, that the conduct of AN&B and I&R was totally unprofessional and in breach of their respective duties as fiduciaries and officers of the court. As such , it is simply inexcusable.

Moreover, it is evident from the extensive record before me that these breaches were not momentary lapses in an otherwise unblemished performance. Rather, the conduct of both firms evinces "a total pattern of conduct which betrays a callous disregard of the professional obligations undertaken in . . . a bankruptcy [proceeding]." *Arlan's Department Stores, Inc., supra,* at 943. Under such circumstances, a Judge would indeed be remiss if he were to permit a law firm guilty of such conduct to be compensated. *Id.* at 944.

In addition, despite the serious nature of these breaches of their professional obligations, both law firms have demonstrated, in the Bankruptcy court as well as on appeal before this court, a cavalier attitude toward these breaches, labeling them "technical breaches" at best.[3]

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[3]The evils of fee splitting are not so easily dismissed, however, as the Advisory Committee's Note to Rule 219 indicates:

> As Chief Justice Taft pointed out in *Weil v. Neary,* 278 U.S. 160, 173 (1929), arrangements for division of compensation are contrary to public policy not only because of 'actual evil results but their tendency to evil in other cases.'
>
> 'Any division of fees or other compensation represents, above all, an incentive for the applicant to claim a compensation high enough to make his own share in it a worthwhile remuneration. It thereby tends toward extravagance of expenditure. Another evil is that it subjects the officer or attorney entitled to compensation to outside influences, over which the court, has no control and which may affect the administration by depriving the court's functionaries of their requisite independence of judgment. Finally, it results in a clear transfer of judicial power over expenditure and allowances from the court to persons who, at best, have a distinctly lesser degree of public responsibilities.' 3A Collier 1637 (1961).
>
> Given this strong public policy against fee splitting, and the dangers likely to result, it is not the type of violation that courts should be quick to overlook. While I am con-

Based upon the specific findings of misconduct made by Judge Lesser below, which were fully substantiated in the record, I find that it was an abuse of discretion to permit either AN&B or I&R to recover any fees in connection with the instant proceeding. *Arlan's Department Stores, Inc., supra*, at 944,

Accordingly, Judge Lesser's opinion, dated September 28, 1979, is affirmed with respect to the vacation of the compensation portion of Judge Herzog's March 11th order and the findings of misconduct on the part of AN&B and I&R, and is reversed insofar as it permitted AN&B and I&R to retain any fees for services rendered to the debtor. Thus, AN&B and I&R are directed to pay to Futuronics all fees collected to date, with interest, and are denied any further compensation.

SO ORDERED.

Dated: New York, New York
June 26, 1980

/s/ Kevin Thomas Duffy
KEVIN THOMAS DUFFY, U.S.D.J.

(footnote 3 continued)

vinced from the record that Judge Lesser was appropriately offended by the "bald fee-splitting agreement" between AN&B and I&R, I find that the sanctions he imposed were overly lenient. Indeed, the awarding of a bonus under such circumstances is totally inappropriate. And, while some may disagree upon whether all compensation should be denied, I am convinced that given the conduct involved herein this is the only appropriate sanction to be imposed.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter	:	No. 75-B-11
of	:	OPINION AND ORDER CONCERNING FEES OF COUNSEL
FUTURONICS CORPORATION	:	Filed Sep. 28, 1979

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STANLEY T. LESSER, *Bankruptcy Judge:*

The decision involves the pending Chapter XI proceeding of Futuronics Corporation ("Futuronics") which has been pending since January, 1975. Predicated on a recovery of $4,650,000 from the United States Government (the "Government") earlier this year, the debtor will be able to propose a plan paying a significant amount, possibly even 100%, to general creditors. As part of what is hoped to be the final stages of this case, I will consider and determine allowances to be paid to the law firms of Arutt, Nachamie, Benjamin, Lazar & Kirschner, P.C. (the "Arutt firm") and Israel & Raley (the "Israel firm").

The controversy over these fees has been waged with considerable heat. Affidavits, supplemental affidavits and further supplemental affidavits have been submitted. Some 1,400 pages of testimony were taken over a period of six days. Multitudinous exhibits were identified and introduced. Extensive briefs were exchanged. The contesting parties were Futuronics, the two law firms, and Futuronics' creditors committee (the "Creditors Commit-

tee"), which stands to gain from the reduction of professional fees. Instead of attempting to deal in detail with the vast array of material referred to above, I will present an overview of the problems raised and attempt to deal only with the most significant events. Much more could be extracted from the record to support the conclusions reached. But that should be unnecessary because of my view that the case is controlled by basic overriding principles applicable to bankruptcy administration in the larger sense.

At the heart of the controversy is the alleged violation by both the Arutt firm and the Israel firm of Bankruptcy Rules 215 and 219. A related question in the case of the Israel firm pertains to the extent to which its order of retention, entered by my predecessor under date of March 10, 1975, is binding on me in prescribing the manner in which the fees payable to the Israel firm should be determined.

I will endeavor to put the situation in perspective by an abridged recitation of facts. On January 3, 1975, the day the Arutt firm filed the Futuronics petition, an order was entered authorizing the retention of the Arutt firm under a general retainer. The Arutt firm served in that capacity until September, 1977, when it was replaced by Schwartz & Sachs, P.C. (the "Schwartz firm"), the members of which had previously been partners of the Arutt firm. To round out the picture on counsel for the debtor, it should also be noted that the Schwartz firm was replaced by Finley, Kumble, Heine & Underberg (the "Finley firm") on October 23, 1978.

Since the Futuronics Chapter XI proceeding was precipitated by what can loosely be referred to as "government contract" problems, it was decided in January, 1975

that special counsel with expertise in this area was required. At the suggestion of Albert Blanck ("Blanck"), president of Futuronics, it was decided that the Israel firm should fill that role. By order entered under date of March 10, 1975 by Bankruptcy Judge Herzog, the Israel firm was retained as special counsel to Futuronics for the purpose of dealing with claims against the Government and potential counterclaims and/or set-offs by the Government against Futuronics. That order (which the parties have referred to as being dated March 11, 1975 and will be so referred to herein) was entered *ex parte,* even though the Creditors Committee and its counsel had already been selected. The order provided that compensation to the Israel firm would be in accordance with the annexed affidavit of Mr. Israel. That affidavit referred to a $15,000 retainer, various percentages of amounts recovered under different contracts, and hourly rates of $100 for Mr. Israel and $85 for Mr. Raley on some of the contracts, to the extent the time expended exceeded the amount calculated as a percentage of the recovery.

The Israel firm worked steadily on the debtor's matters during 1975 and into 1976. Some progress was made. The $15,000 fee retainer was paid in March, 1976. From time to time during 1976 additional payments of approximately $115,000 were made to the Israel firm in purported reliance on Judge Herzog's March 11, 1975 order and without specific applications or orders with respect thereto. At an adjourned first meeting of creditors in April, 1976, shortly after my appointment as Bankruptcy Judge, I was initially advised of the existence of Judge Herzog's March 11, 1975 order and its contingency provisions. Although inexperienced in questions of compensation in bankruptcy cases, I expressed serious reservations about the suitability of such an agreemnt, in a case such as

Futuronics, where a change in the Government's termination of the debtor's contracts from "default" to "convenience" would result in the recovery of millions of dollars. The remarks in question prompted the Arutt firm to include the following statement in an April 28, 1976 letter to the Israel firm:

> "He [the judge] feels that same [your retainer agreement] might be unreasonable in that your fees on a contingency basis might equal $2 million."

The question of the contingent fee arrangement was discussed by the court from time to time during 1976 as certain additional payments came to light in the monthly financial statements filed by Futuronics. During the period in question, the court stated that it would not be bound by Judge Herzog's March 11, 1975 order, unless irrevocably committed as a matter of law, and reserved the right to fix the ultimate compensation of the Israel firm in accordance with accepted bankruptcy criteria. Following the further payment of some $48,000 to the Israel firm in October, 1976 on the strength of the March 11, 1975 order, I directed the debtor to refrain from making further payments to the Israel firm without the entry of a specific court order upon proper application therefor. Throughout the entire case, the Israel firm, and the Arutt firm on its behalf, argued strenuously that Judge Herzog's March 11, 1975 order was a final and irrevocable mandate for the automatic payment of fees to the Israel firm, and that the undersigned lacked authority to reconsider or change its provisions.

Since the trial of the debtor's case against the Government before the Armed Services Board of Contract Appeals lay in the future, I told the parties that the nature of

the disagreement was on the record, that it would be wasteful to adjudicate it before there was a meaningful recovery against the Government, and that the Israel firm could press its position if, as and when there was a successful end of the litigation. Thereafter, in accordance with the Court's direction, orders were presented and signed for the payment of fees and disbursements to the Israel firm. Some orders were refused. All of the orders signed either deleted reference to Judge Herzog's March 11, 1975 order as the source for payment or provided that the payments authorized were subject to further court orders fixing final compensation of the Israel firm. The first of such orders was entered under date of December 27, 1976.

Turning to the Arutt firm, it is fair to say that from April 1976 to April 1977 it appeared to the court that the Arutt firm was in full control of the case. The Israel firm was performing certain special services specifically directed to the Government contract disputes, but the Arutt firm was doing everything in the New York area and was representing the debtor vis-a-vis the Creditors Committee, secured lenders and various non-technical Government contract matters. Gary Sach, Esq. was the attorney that represented the Arutt firm in virtually all facets of the matter. In April, 1977 the Arutt firm submitted an interim fee application for $23,585, representing time charges for approximately 450 hours of professional services less the $10,000 retainer that had been paid at the outset of the case. Paragraph 117 of the Arutt firm interim fee application mentioned the expenditure during the period in question of some 400 additional hours of professional services, "with reference to the government litigation for which applicants are not requesting compensation." The summary of hours and rates annexed to the interim application reaf-

firmed the point by stating, "No charge on services for government litigation. No less than 400 hours expended at average hourly billing of $80 per hour." In view of the uncertain outcome of the Government litigation and opposition by the Creditors Committee, action on the Arutt firm's interim application was deferred. However, the clear understanding of the Court, reasonably inferred from the quoted language above, was that the Arutt firm recognized the need to defer any request for compensation for services in the Government contract litigation until later in the case.

Substantial progress was made in the debtor's litigation against the Government during 1978. The exhaustive documentation compiled by the Israel firm and matters revealed in the initial hearings before the Armed Services Board of Contract Appeals led the Administrative Judge to direct that settlement negotiations be held. This led to an overall settlement between Futuronis and the Government that was advantageous to Futuronics. The January 1979 settlement stipulation, which was subject to approval of the Bankruptcy Court, provided that (1) the Government would pay Futuronics $4,650,000; (2) the Government would withdraw its $8,700,000 claim in the Futuronics' Chapter XI case; and (3) portions of filed and unfiled claims by subcontractors of Futuronics would be paid directly by the Government, relieving Futuronics of responsibility therefor, as if the prime contracts in question had been terminated for the convenience of the Government.

The undersigned approved the settlement after a hearing held in February, 1979. Futuronics and its counsel were authorized to take whatever steps were necessary to effectuate the settlement. The Court enthusiastically expressed

its praise for the work done by the Israel firm and for the competence, vigor and steadfastness that had been displayed by the Israel firm in pursuing the rights of Futuronics. Shortly thereafter, the Israel firm submitted orders seeking to have the Court fix its compensation for work in the Government contract litigation in accordance with the contingent provisions of Judge Herzog's order. The undersigned refused to sign such orders and repeated its previously expressed intention to fix the compensation of the Israel firm in accordance with ordinary bankruptcy practices, unless precluded from doing so as a matter of law. The compensation orders submitted by the Israel firm in February, 1979 were also opposed by the Finley firm, as counsel to Futuronics, and the Creditors Committee. In an effort to bring the matter to a head, the Court wrote on March 21, 1979 suggesting that the Israel firm, while pressing its previous position,

> "consider a submission justifying the compensation requested in accordance with the standards and procedures prescribed in Bankruptcy Rule 219, made applicable in arrangement cases by Bankruptcy Rule 11-31. I see no reason why the latter cannot be done without prejudice to your [the Israel firm's] reliance on Judge Herzog's March 11, 1975 order for determining the quantum of your compensation."

The procedure suggested in the Court's letter of March 21, 1979 brought forth from the Israel firm, in affidavit form sworn to April 9, 1979, an extensive document headed, "Statement of Services Rendered by Special Counsel." Paragraphs 17 through 19 of that affidavit disclosed for the first time, at least to the Court, that the Israel firm had paid the Arutt firm some $60,067.33 prior to the Arutt firm's being replaced by the Schwartz firm in

September, 1977. The affidavit in question explained that the need had arisen for local work in New York and that the Arutt firm had been engaged and had been paid in response to bills rendered from time to time.

In giving a detailed description of the services in question, the April 9, 1979 affidavit disclosed that for the period from January, 1975 to February 16, 1979 the Israel firm had expended 6,429 hours of professional services on behalf of Futuronics.

The disclosure of the payments to the Arutt firm by the Israel firm in the April 9, 1979 affidavit brought forth the application by the Finley firm, on behalf of Futuronics, to deny all compensation both to the Israel firm and to the Arutt firm on the basis of a violation of Bankruptcy Rule 219's interdiction against the sharing of fees. What the Court had believe was to be a proceeding to assess the reasonable value of fees to be paid to the Israel firm for a job well done, and the binding effect, if any, of Judge Herzog's March 11, 1975 order, took a radically different turn.

While there is conflicting evidence as to the extent to which Futuronics, Blanck, the Creditors Committee, or its attorneys may have been aware of the arrangements and/or payments between the Israel firm and the Arutt firm, the issue is totally irrelevant. The only matter of importance, about which there is no dispute, is that the Court was totally ignorant of the entire situation. This continuous and concerted nondisclosure to the Court is made worse, in my view, by the fact that there were numerous occasions which presented the opportunity to remedy the situation. At the trial, the Arutt and Israel firms took the position either that disclosure was not re-

quired or that it was not known that disclosure was required. I reject both positions, out of hand, on the law and on the facts.

It came out at the hearings that the order signed on March 11, 1975 was not the first order presented to Judge Herzog for retention of the Israel firm. A previous order had been presented and rejected by him in February 1975. Although the form of that order and its supporting papers were not produced at trial, there was introduced a January 30, 1975 retainer letter, from the Israel firm to the Arutt firm, intended to be signed also by Futuronics, which enclosed an affidavit of Mr. Israel for submission to the Court in support of the order of special retention. Paragraph 5 of the January 30, 1975 letter states that the Israel firm would pay to the Arutt firm "one-third of all fees received for professional legal services and assistance agreed to be rendered by the law firm of Arutt, Nachamie & Benjamin to the law offices of Fred Israel in relation to the contract claims of Futuronics against the United States Government". Predicated on the testimony and circumstantial evidence concerning the origin of that arrangement, it is my conclusion that it was a bald fee-splitting agreement, foistered on the Israel firm by the Arutt firm, but accepted by the Israel firm with full knowledge of its implications, notwithstanding the cosmetic reference to services and assistance to be contributed by the Arutt firm. The affidavit of Mr. Israel enclosed with the January 30, 1975 letter contains in paragraph 10 slightly different language than that contained in the January 30, 1975 letter, but ends with the statement "Based on the services agreed to be rendered by ANB, we have agreed to distribute fees received by us on a basis of two-thirds to ourselves [the Israel firm] and one-third to ANB."

We know that such an order was never signed. We do not know why. Paragraph 13 of the affidavit of Samuel Arutt, sworn to July 11, 1979, states that Judge Herzog "refused to sign the order [of February, 1975] because of the 1/3-2/3 provision." I have no reason to doubt the veracity of this statement. While there must have been some application submitted in connection with the rejected February, 1975 order, there is no suggestion that the January 30, 1975 letter was ever submitted to Judge Herzog.

Following Judge Herzog's rejection of the February retention order, the Israel firm prepared a revised retainer letter under date of March 3, 1975 and sent it to the Arutt firm with a replacement affidavit. Although the replacement affidavit omitted paragraph 10 of the old affidavit, and the objectionable language on fee-splitting, the March 3, 1975 letter nevertheless contained the following provision:

> "In view of the fact that we will be looking to your law firm for legal services and assistance in connection with the matters we are undertaking under the agreement, and may be working through your firm with the creditors to try to effect an agreement with the United States, I would suggest that you prepare appropriate billings for your time and, at the conclusion of this matter, we could go to the Court and recommended to them how the fees are to be distributed. Please provide us with copies of your time records."

A perfunctory application and the revised affidavit was submitted to Judge Herzog in support of the entry of the March 11, 1975 order. The March 3, 1975 retainer agree-

ment was omitted. Even if we were to accept the contention that the fee-splitting agreement had been abandoned, nowhere was it disclosed to Judge Herzog that the above-quoted agreement between the Arutt and Israel firms had been substituted in its place. This total lack of disclosure was compounded by the closing litany in the application for the March 11, 1975 order which piously recounted that "no prior application" had been made for the relief requested therein.

Although there is no desire to unduly prolong this opinion before undertaking an analysis of the applicable legal principles, it must be recorded clearly that the Israel firm applied for compensation from the Court in one form or another on perhaps a dozen occasions commencing in December, 1976, that the Arutt firm participated in and urged the approval of each such application through September, 1977, and that the Schwartz firm did the same during its tenure as counsel to Futuronics from September, 1977 through October, 1978. It must also be stated that during the course of at least one long conference in chambers during 1977, called for the purpose of discussing the Israel fee situation, the Court explained in part its refusal to grant pending applications for allowance because the Israel firm had already been paid all, or almost all, of its time costs on the Futuronics matter. In response, the Israel firm urged the finality of Judge Herzog's order and attempted to convey the financial hardship that the Futuronics case had imposed on its office. Mr. Israel and Mr. Raley pressed their position with great vigor and some emotion. It is inexplicable, and totally inconsistent with the Israel firm's present position that it never doubted the propriety of its arrangement with the Arutt firm, that neither Mr. Israel nor Mr. Raley disclosed

to the Court the precipitating cause of its financial hardship in the case, to wit, that it had paid the Arutt firm approximately one-third of the funds that had been received from Futuronics.

By January 1975 Bankruptcy Rules 215 and 219 governing retention and compensation of attorneys had been promulgated by the Supreme Court and were fully effective. They had been discussed in the profesional literature and at seminars. They were well known. They had been incorporated into the Collier Treatise on Bankruptcy. Their provisions were not new. They merely clarified and refined what had existed for many years in the Bankruptcy Act and the General Orders in bankruptcy. They were consistent with principles underlying the Canons of Professional Ethics. They were founded on two pillars – full disclosure and ultimate responsibility in the Bankruptcy Court for the determination of reasonable fees in each case.

Any attempt by the Arutt firm to feign ignorance of the Rules must be rejected out of hand. Its fee applications extol its expertise and experience in the insolvency field, and the position of importance held by its members in insolvency publications and associations. Even if the Israel firm's contention that it knew nothing about bankruptcy at the inception of the case is accepted at face value, the suggestion that its state of blissful ignorance continued to the date of trial is unconvincing.

The Israel firm consists of capable experienced attorneys. Their success against the Government resulted from their mastery of a mass of material and the intricacies of Government procurement regulations. They must be held responsible for knowledge of Bankruptcy Rules 215 and 219, particularly after the Court announced that it would not be bound by Judge Herzog's order and

that the Israel firm's compensation would be fixed in accordance with standard bankruptcy procedures. It is unthinkable that they did not at least research how good their case was on making Judge Herzog's order stick; and what they would have to deal with if the position of his successor prevailed. I charge them with having done so, whether or not in fact they did.

Bankruptcy Rule 215(a) provides that no attorney for the "debtor" (see Bankruptcy Rules 11-2 and 11-22) shall be employed except upon order of the court. Both the Arutt and Israel firms were indeed each retained by court order. The order of retention is to be entered only upon application of the debtor in possession stating, among other things, all of the attorney's connections with the debtor and its attorney.

The original application for the retention of the Arutt firm was in accordance with the Rule. The application which led to the March 11, 1975 order concerning the retention of the Israel firm was not. It was applied for not by the debtor but by the Arutt firm on the debtor's behalf. It did not contain the affirmation of Blanck as president of Futuronics. It did not reveal the connections between the Israel and Arutt firms under the discarded January 30, 1975 letter and the undisclosed March 3, 1975 letter. Its statement that there had been "no prior application for the relief sought" was untrue. The order itself, if given the meaning attributed by the Israel firm, was clearly defective. Bankruptcy Rule 11-24(a)(7) requires a ten day notice to all creditors or, by court action, to the Creditors Committee, of a hearing on an application for allowances by an attorney. If the March 11, 1975 order was a self-executing action for the granting of attorneys' fees, it could not be granted *ex parte*. Judge Herzog knew this because of his intimate connection with the drafting and promulgation of

the Rules. I must assume that he did not intend to enter an order contrary to the Rules he had fought to have adopted. I can only assume that Judge Herzog considered the March 11, 1975 order as a mere authorization to retain the Israel firm under Bankruptcy Rule 215. He may have inadvertently failed to add a provision I have seen in other orders from the same era that final compensation would be fixed after hearing and notice and the submission of an appropriate application therefor.

Without indulging in unnecessary overkill, I point out also that one of the first steps to be undertaken by the Israel firm was the submission to the Air Force of a request for an amendment without consideration of Contract 3556. The decision to do this had already been made and may well have been in process when the March 11, 1975 order was submitted to Judge Herzog. If granted, the amendment without consideration would have yielded several millions of dollars for Futuronics. If the Israel firm's interpretation of Judge Herzog's order is correct, it would have received a fee of hundreds of thousands of dollars for a relatively few hours of work over a relatively short period. None of this has been shown to have been known to Judge Herzog.

The entire process pertaining to the entry of the March 11, 1975 order either was calculated to deceive Judge Herzog or was rife with deficiencies which undercut its very existence. In either event, I hold that it is invalid in all respects, except to the extent that it gave the Israel firm official status to represent Futuronics in the Government contract litigation.

A further postscript on this point is also necessary with respect to the Arutt retention order of January 3, 1975. While not specifically covered by the Rules, I believe that it is inherent in the fiduciary relationship of any profe-

sional to the court to apprise the court if there is any change in any material matter relating to its order of retention. At January 3, 1975 Arutt apparently had no connection with any attorney for Futuronics. The court had rejected the arrangement provided in the January 30, 1975 letter. The arrangement contemplated in the March 3, 1975 letter was well within the area of disclosure required by Bankruptcy Rule 215(a) for a new retention. Judge Herzog, and the Creditors Committee, were entitled to be fully informed so as to determine both the appropriateness of the arrangement and its impact on the ability of the Arutt firm to continue to serve Futuronics under a general retainer. There must be absolute candor between counsel and the Court in bankruptcy proceedings concerning matters of retention and fees. There must be a leaning over backwards to make disclosure. Comparable to Rule 10b-5 under the Securities Exchange Act, there can be no omissions which make what is said in any way misleading. Half truths and negative pregnants are abhorrent to the disclosure required. If no other grounds existed, I would rely on the foregoing to support a holding under Bankruptcy Rule 215(b) that the March 3, 1975 understanding with the Israel firm constituted the acquisition of an "interest adverse to the estate" in a matter on which the Arutt firm had been employed.

While on the subject of Bankruptcy Rule 215, and the issue will be placed in sharper focus under Bankruptcy Rule 219, note should be taken of Bankruptcy Rule 215(f) and its implied prohibition of the type of legal service subcontracting that was engaged in by the Israel firm herein. The court is entitled to know who toils for the debtor and in what capacity. The only exception is for members or regular associates of a firm. No one else can perform services within the scope of a retention authorized under

Bankruptcy Rule 215(a), "without further order of the court."

The Arutt and Israel firms have used their days in court to protest their innocence of any conduct proscribed by Bankruptcy Rule 219. In doing so, they have relied on forced and tortured meanings of words and concepts that were intended to have broad scope and sweeping effect. Notwithstanding anything that has been suggested to the contrary, the first sentence of Bankruptcy Rule 219(a) is mandatory. No amount of semantic legerdemain can undercut the clarion call that persons seeking compensation from an estate must file an application which complies with Bankruptcy Rule 219. Similarly, both the Arutt and Israel firms have blatantly violated the second sentence of Bankruptcy Rule 219(a). I will not here speculate on their motives or purposes.

The interim fee application of the Arutt firm filed in April, 1977 did not disclose the fees received from the Israel firm. The argument that only fees paid by the debtor itself are covered verges on an insult to the intelligence of the Court. Such an interpretation would open the way to rampant evasion and skulduggery – the direct opposite of what was intended. The language requires disclosure of all payments, (1) made or promised, (3) for services in any capacity, (3) rendered in or in connection with the case, and (4) the source of the compensation. The language "in any capacity" and rendered "in or in connection with the case" leaves the argument of the Arutt firm totally naked. The Arutt firm was retained under a general retainer. it urged on Judge Herzog the need for special counsel. It is not unusual for general counsel to supervise, or even assist special counsel, so long as there is no unreasonable duplication of effort. This supervisory function may indeed be part of its professional responsibility in the case.

To the extnt the Arutt firm worked reasonably with the Israel firm, it would have been entitled to seek compensation in an application filed under Bankruptcy Rule 219(a). The remedy of self help was not available to it. The foregoing probably does not apply to a situation such as was involved in Futuronics, where approximately half the Arutt time spent on the case was billed to special counsel. Where so much of its efforts are being devoted to a cause that the Court believes is being handled by special counsel, the general counsel is under a duty to come forward and seek a modification of the retention order of special counsel, its own retention order or both.

The Arutt firm is also at fault, in submitting applications of the Israel firm, in failing to disclose its interest therein. Whatever testimony has been given about the obligation of the Israel firm to pay the Arutt firm, regardless of itself being paid, it is obvious from the facts that the Israel firm never paid the Arutt firm before it had received more than the amount in question from the debtor; and that after the payment of fees to the Israel firm was curtailed by the Court, it advised the Arutt firm, and the Schwartz firm, thereafter, that it would not be responsible for charges unless for services requested in writing. Not unexpectedly, the call for assistance never came.

By virtue of the foregoing, I find that both the Arutt and Israel firms, until the disclosures made in April, 1979 and thereafter, violated that portion of Bankruptcy Rule 219(a) which required disclosure of agreements for "the sharing" of compensation received for services rendered in or in connection with the case. Clearly, the Israel firm received compensation for services rendered in or in connection with the case. As I view the situation, it shared

$60,000 of its compensation with the Arutt firm. The former was the "sharor", the latter was the "sharee". Bankruptcy Rule 219(a) requires disclosure from both.

As with my previous discussion of the January 3, 1975 Arutt retention agreement, I would also say that an attorney, an officer of the Court, has an affirmative obligation to amend the disclosure statement filed under Bankruptcy Rule 219(b) to reflect any material changes therein, even if occurring after the first date set for the first meeting of creditors. Again, the purpose of all this is to lay upon the table, for the Court and all interested parties to see, exactly what arrangements the attorneys have made for and among themselves. The subject is a sensitive one with Congress and has been so for some time. Attorneys and judges should be equally or more sensitive.

Bankruptcy Rule 219(d) is not a disclosure provision such as Bankruptcy Rule 219(a) or (b). It is an outright prohibition against sharing with another "in any form or guise" compensation received for services "in or in connection with" the case. There is a corresponding prohibition against sharing or agreeing to share in the compensation of another for rendering services in or in connection with a case. As with Bankruptcy Rule 219(a) discussed above, I find that the Arutt firm was a "sharee" and the Israel firm a "sharor," in violation of Bankruptcy Rule 219(d).

It has been argued by the Israel and Arutt firms that Bankruptcy Rule 219(d) permits unrestricted sharing of compensation for services rendered by an attorney for "a bankrupt" with another attorney who contributes thereto. There are several grounds for rejecting the argument. First, while sharing of compensation for contributed services is not improper, the recipient of the shared compensation must himself have been retained under Bankruptcy Rule 215. Second, in the context of a Chapter XI case,

sharing under Bankruptcy Rule 219(d) with an attorney (outside the retained attorney's firm) must be limited to services pertaining to the preparation of the original Chapter XI petition. While Bankruptcy Rule 11-31 makes Bankruptcy Rule 215 applicable in Chapter XI cases, Bankruptcy Rule 11-2 rationalizes the differences in terminology by providing that "bankrupt" means "debtor" and that "trustee" means "debtor continued in possession."

Accordingly, the only fee sharable under the provision in question is the retainer received by the Arutt firm in advance of filing the case. The above discussion merely confirms the previous finding that both firms violated Bankruptcy Rule 219(d).

While the views discussed above have been independently reached, they are not matters of first impression. I have avoided citing authorities because what is said is self-evident. However, the sentiments expressed are shared *in toto* by the editors of Collier. The discussion in 3A *Collier on Bankruptcy* § 62.37 (14th ed. 1978) at pp. 1636-39 is particularly apt. I commend it to all for reading, as well as the full text of Chief Justice Taft's opinion in *Weil v. Neary*, 278 U.S. 160 (1929), which is as true today as it was then.

We come then to the difficult part of the decision. What to do. The final sentence of Bankruptcy Rule 219(d) makes clear that the Court may enter such order against the miscreant as the Court deems appropriate, including denying his compensation in full. But the Advisory Committee's Note makes clear that denial of compensation is not an exclusive remedy. 3A *Collier on Bankruptcy* § 62.05[5] (14th ed. 1978) contains the cryptic statement that improper conduct on the part of attorneys "has frequently been penalized by withholding compensation . . . [and] courts have repeatedly used it as the most effective weapon against . . . improper arrangements between

[attorneys]. . . ." We are all aware of the stern medicine handed out by Judge Carter in *Arlan's Department Stores, Inc.*, 462 F. Supp. 1255 (S.D.N.Y. 1978), a case presently on appeal before the Second Circuit.

While I am convinced that the prophylaxis prescribed by Judge Carter in *Arlan's* could be supported under the standard of review set forth in Bankruptcy Rule 810, I am not disposed to go that far. *Arlan's* was a disappointing liquidation case. Here, where creditors and shareholders started out with little, there will be a handsome payment for the former, and possible equity for the latter. The Israel firm, with some help from the Arutt firm, created the fund. they are the collective goose that laid the golden egg. Depriving them of all compensation would provide an unjustified windfall for creditors and shareholders alike. In this regard, Blanck's knowledge of both the January 30 and March 3, 1975 retainer letters, and his signature on the latter, are significant. But there should not be a shadow of a doubt that the conduct, and the attitude of both the Arutt and the Israel firms are totally unacceptable. Paraphrasing the words of Justice Cardozo in the well-known case of *Meinhard v. Salmon,* attorneys dealing with the Bankruptcy Court will be required to act with the "punctilio of honor" required of a fiduciary without regard to the morals of the marketplace.

Proper policing of the legal profession must come from within. Attorneys must act in a way which precludes the possibility of criticism of the profession and the judicial system. Hopefully, it will not again be necessary for a judge to write an opinion such as this or that of Judge Carter in *Arlan's.*

Arutt, Nachamie, Benjamin & Lazar, P.C.

The $60,067.33 paid to the Arutt firm by the Israel firm cannot be retained. It was received without authority and represents the fruits of overreaching. The appropriate

relief is to have it repaid to Futuronics, with interest, computed at the rate of 6% per annum for each payment from the date of receipt by the Arutt firm to the date of repayment to Futuroncis. The more than 400 hours of professional time which were billed to the Israel firm are hereby declared to be non-compensable under the January 3, 1975 order retaining the Arutt firm.

Other than the above, the Arutt firm expended some 470 hours of professional time on behalf of Futuronics and requests an allowance therefore of $36,635, to be paid less the retainer of $10,000 received at the outset of the case. The request is not excessive for a successful Chapter XI case and is allowed in full.

Israel & Raley

Although I will deal below with the contention of the Israel firm that the contingencies listed in the affidavit referred to in Judge Herzog's March 11, 1975 order must be applied without subjective evaluation, I will consider at this point the fixing of an allowance to the Israel firm under the criteria set forth in Bankruptcy Rule 219(c)1, adjusted as I deem appropriate in the exercise of the discretion referred to in the final sentence of Bankruptcy Rule 219(d).

I do not retract my statements of commendation for the manner in which the Israel firm handled the Government litigation. I would have hoped that such competent advocates would have been capable of stauncher resolve in their dealings with the Arutt firm, and greater respect for the Bankruptcy Court, or at least the candor required in dealing with it, regardless of the written words of the Rules. I truly hope that their conduct was not motivated by a quest for easy money. Competent attorneys, with the capacity for hard work and perseverance, qualities which the Israel firm has amply demonstrated, ultimately receive substantial professional and financial recognition.

In comparison to most other bankruptcy situations, the instant case is rather unique. Rates of compensation in other cases, or the relationship between the amount recovered and the fee granted, may not provide a true test because of the large number of hours expended by the Israel firm and the substantial benefit conferred on the estate. I am attracted for guidance to the decision of the Second Circuit in *City of Detroit v. Grinnell,* 560 F.2d 1093 (2d Cir. 1977), which represented the judicial culmination of five years of controversy over fees to be awarded to counsel in a class action antitrust case.

The basic approach in *Grinnell* was to establish a "lodestar" figure, or hourly rate, for the time expended and then to determine which, if any, of the hours were entitled to a premium. In determining the premium to be allowed in *Grinnell,* the court was quick to point out, in regard to the so-called "risk of litigation" factor, "that an attorney will receive an otherwise reasonable compensation for his time from the lodestar figure alone." Interesting also is the statement in *Grinnell* that "we reject as having no relevant precedential value cases involving contingent fees arranged by agreements with clients." It is obvious that the contingencies reflected in the original January 30, 1975 retainer letter were fixed for the most part, by lawyers who had agreed to hire them on a two-thirds/one-third basis. Making Bankruptcy Rules 219 and 220 applicable to Chapter XI is further implementation of the recognized principle that a financially distressed debtor is in no position to bargain at arms' length with the attorneys upon whom he must rely to steer a course through the reefs and shoals of liquidation to a safe harbor of rehabilitation.

Most of the 6,400 hours claimed by the Israel firm were spent by Raley, whose hourly rate at the time of the original retention was stated as $85. Although some of the time recorded clearly related to matters other than the

Government contract litigation, I will allow the time in full for purposes of determining the fee. Also, since Raley was a partner of the Israel firm for most of the period during which the services were rendered I will fix a "lodestar" figure of $100 per hour to all time expended by the Israel firm in the Futuronics matter. Thus calculated, we start with a fee of $640,000 for the Israel firm. There is then the question of fixing a suitable bonus, if any. As the Second Circuit said in *Grinnell,* "A long and complicated trial would be an example" of a factor to be considered in fixing a bonus above the "lodestar" figure. That situation is not present here. To the contrary, the Israel firm originally contemplated a day in and day out trial lasting six to nine months. The settlement obviated this burden. Accordingly, the main factors in considering a bonus in this case are (1) the favorable result, (2) the risk of not getting paid for a substantial number of the hours invested in the case, and (3) the concentrated effort expended on the case which precluded the Israel firm, or at least Mr. Raley, from spending a significant amount of time on other litigation. In the absence of the Rule 219 problem, I would award the Israel firm a bonus of $400,000, representing a doubling of the "lodestar" figure for 4,000 of the hours devoted to the case. Against this final fee of $1,040,000 would have been credited the $218,380 previously received by the Israel firm for services, as opposed to disbursements, via direct payments from Futuroncis and payments pursuant to court order after December 1976.

It can be argued that the lapses of the Israel firm were less severe than those of the Arutt firm; and that the Arutt firm has been penalized only by being denied compensation for some 400 hours of work. That analysis is unacceptable. To the extent the Israel firm had more at stake, it should have been more scrupulous and steadfast in complying with the Bankruptcy Rules. There is a great temptation to limit the compensation of the Israel firm to the "lodestar" figure. However, after crediting the

$218,380 already received (which includes $60,000 paid to the Arutt firm), the net payment to the Israel firm for the overall time expended and the benefits conferred on the debtor would be unreasonably low. Although incapable of being determined with calculator-like precision, and in the exercise of my discretion, I hereby fix the final allowance of the Israel firm for all services rendered to Futuronics at $850,000. By giving credit to Futuronics for the $218,380 already paid, the net payment to the Israel firm at this time will be $631,620. As I understand it, all disbursements of the Israel firm have been paid. If that is not the case, they are authorized to submit an additional bill for consideration by the debtor. It goes without saying that expenses related to the fee application and the litigation connected with it are outside the scope of the foregoing.

Although the foregoing disposes of determining the fees to be paid to the Israel firm, there must be some discussion of the argument that Judge Herzog's March 11, 1975 order created something akin to a binding contract between the Israel firm and the court, that it created vested rights in the Israel firm, and that I, as Judge Herzog's successor, was powerless to review or change it.

The exact argument was rejected in *Carter v. Woods*, 433 F. Supp. 291 (W.D. Mo. 1977), where an attorney was retained on a contingent fee basis by the trustees in bankruptcy with the court's approval. The opinion of District Judge Hunter is a sound and scholarly discussion of many of the issues raised in this case. In finding that it was unnecessary to reach the question of whether contingent fee contracts were invalid *per se* in bankruptcy, he proclaimed "that the Bankruptcy Court, in the exercise of its discretion under Rule 219, Rules of Bankruptcy, has the power, indeed the duty, to assure that no fee *other than a reasonable fee* be paid to attorneys who represent trustees, and other parties, in Bankruptcy proceedings." 433 F. Supp. 291 at 293. After reciting the

pertinent portions of the Advisory Committee's Note to rule 219, he added:

> "these concerns, together with the general policy in the Bankruptcy area against any 'transfer of judicial power over expenditure and allowances from the court to persons who, at best, have a distinctly lesser degree of public responsibilities,' . . . make clear that the law does not permit a Bankruptcy Court to contract away its obligation, under the law, to grant only reasonable compensation to attorneys for their services rendered in the administration of a bankrupt estate." 433 F. Supp. 291 at 294.

Courts have previously considered and rejected the argument that an order such as that entered by Judge Herzog on March 11, 1975 must stand because no appeal from it was taken. In *Matter of Pottasch Bros. Co., Inc.*, 79 F.2d 613 (2d Cir. 1935), it was held that even though appeal from an order of the bankruptcy court is a possible remedy, since there are no terms in the bankruptcy court the bankruptcy judge should not be prevented, even though the time for appeal has passed, from modifying or vacating his own orders. If Judge Herzog had the power to modify or vacate the order of March 11, 1975, I, as his successor, based on an independent evaluation of the facts, certainly had the power to do so. The holding of *Pottasch* is memorialized in 7 *Moore's Federal Practice*, § 60.18[7] (Second Edition 1979):

> "There is a practical utility in the application of a rule which permits the vacation or modification of bankruptcy orders where subsequent events presented during administration demonstrate the necessity therefore."

Numerous cases subsequent to *Pottasch* have held that Section 39c of the Bankruptcy Act does not bar the

"horizontal review" of orders entered by the bankruptcy court, particularly administrative orders relating to fees. *Pfister v. Northern Illinois Finance Corporation*, 317 U.S. 144, 153 (1942); In re Meter Maid Industries, Inc., 462 F.2d 436, 439 (5th Cir. 1972); *In re Brendan Reilly Associates, Inc.*, 372 F.2d 235, 239 (2d Cir. 1967). *Pfeffer Jewelers, Inc., v. Winard*, 486 F.2d 610 (9th Cir. 1973), is easily distinguishable. The question there was the timeliness of the attorney's appeal from the order fixing his compensation. "This was not an administrative order entered without opposition after informal proceedings . . ." 486 F.2d 610 at 611.

The question has recently been considered in a broader context by the Second Circuit. *Texlon Corporation v. Manufacturers Hanover Commercial Corp.*, 596 F.2d 1092 (1979) stemmed from a situation in which Bankruptcy Judge Babitt, although believing that a previous order of his was improper, determined that under the circumstances of the case he was precluded from vacating it. The Second Circuit upheld Judge Brieant's reversal of that portion of Judge Babitt's decision. Section III of Judge Friendly's informative opinion addresses itself directly to the question of the Bankruptcy Court's power to modify prior orders after the period for appeal under Bankruptcy Rule 802 has elapsed. The court in *Texlon* concluded that Bankruptcy Rule 924 had not blunted the effect of *Wayne United Gas Co. v. Owens-Illinois Glass. Co.*, 300 U.S. 131 137-38 (1937) and *Pfister, supra*. Under *Texlon*, once the Bankruptcy Judge concludes that an administrative order has been entered in error, it may be re-examined before rights have "vested" or will be "prejudiced." Neither of these conditions is present here in the judicial sense intended in *Texlon*.

The Israel firm was advised early in 1976 that the Court disapproved Judge Herzog's order. They were on notice that their services would be measured by ordinary

bankruptcy standards, unless they could establish, as Manufacturers Hanover Commercial Corp. failed to do in *Texlon,* that Judge Herzog's March 11, 1975 order was not reviewable under any circumstances. On the facts, *Texlon* is a more difficult case than Futuronics. In *Texlon,* the Second Circuit had no difficulty in holding that the secured lender neither had vested rights nor would be sufficiently prejudiced to prevent the exercise of the Bankruptcy Judge's power to re-examine and alter his prior order. The same is true of the Israel firm here.

By January, 1977 the Israel firm knew that no further payments would be made to it without specific court order, and that the court's December 27, 1976 order, which authorized an interim payment of $46,916.97, stated that it was "subject to such further orders as may be made concerning the fixing of final compensation." At that date, by its own time records, the Israel firm had expended 1,665.25 hours equivalent to $148,149.50 and had received from Futuronics in excess of $172,000.

It is, accordingly, ordered that the Arutt firm repay to Futuronics the sum of $60,067.33, plus interest at the annual rate of 6% per annum from the date of the various payments it received from the Israel firm, less the net allowance of $26,635.00 granted to it herein, and it is further

Ordered, that the Debtor pay to the Israel firm for all services rendered as special counsel the sum of $850,000 less $218,380 already paid, or a net payment at this time of $631,620.

/s/ *Stanley T. Lesser*

BANKRUPTCY JUDGE

Dated: New York, New York
September 28, 1979

APPENDIX B

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 4th day of Sept., one thousand nine hundred and eighty-one.

Filed Sep 4, 1981

In the Matter of
FUTURONICS CORPORATION,

Debtor,

FUTURONICS CORPORATION,
Debtor-Appellee-Cross-Appellant,

-v-

ARUTT, NACHAMIE & BENJAMIN
and ARUTT, NACHAMIE, BENJAMIN,
LAZAR & KIRSCHNER, P.C.,
Appellants-Cross-Appellees,

ISRAEL & RALEY,
Appellant-Cross-Appellee

— Nos. 80-5032 —
80-5033
80-5046
80-5048
80-5050

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellant-cross-appellee, Israel & Raley, and the panel that heard the appeal having denied said petition for rehearing,

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel

that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/ *A. Daniel Fusaro*
A. Daniel Fusaro
Clerk

APPENDIX C

SOUTHERN DISTRICT OF NEW YORK

In the Matter 79-Civ-6305(KTD)
Cross-Judgment

of

FUTURONICS CORPORATION,

Debtor.

This matter having come on to be heard on the 8th day of January 1980, before the Honorable Kevin Thomas Duffy, one of the judges of the United States District Court for the Southern District of New York, as an appeal and cross-appeals from a decision and order of the Bankruptcy Court dated September 28, 1979, issued by Bankruptcy Judge Stanley T. Lesser; Futuronics Corporation having duly appeared by its counsel Finley, Kumble, Wagner, Heine & Underberg, Esqs. (Gary L. Blum, Esq., of counsel), and Israel & Raley, having duly appeared by their counsel Hall, Dickler, Lawler, Kent & Howley, Esqs. (Joseph Chase, Esq. and Mortimor S. Gordon, Esq., of counsel), and the Court having rendered its Opinion and Order dated June 26, 1980 and said Opinion and Order having been filed and accompanying the Judgment herein,

NOW IT IS ORDERED, ADJUDGED AND DECREED that Futuronics Corporation, having its place of business at 99 Powerhouse Road, Roslyn Heights, New York, have judgment and due recovery from the law firm of Israel & Raley, having its place of business at 1015 18th Street, N.W., Washington, D.C., the sum of $158,312.91 together with interest thereon at the rate of 6% per annum from July 24, 1980; and it is further

ORDERED, ADJUDGED AND DECREED that the sum of $158,312.91 shall bear interest at the rate of 6% per annum until paid and satisfied; and it is further

ORDERED, ADJUDGED AND DECREED that the law firm of Israel & Raley is denied all compensation for legal services rendered on behalf of Futuronics Corporation; and it is further

ORDERED, ADJUDGED AND DECREED that the Opinion and Order of this Court dated June 26, 1980 is incorporated herein by reference and affirms the Opinion and Order of Judge Stanley T. Lesser dated September 28, 1979, which is also herein incorporated by reference with respect to the vacation of the compensation portion of an Order of Judge Asa S. Herzog, dated March 11, 1975 and the findings of Judge Lesser of a violation of Rule 215 and 219 of the Bankruptcy Act & Rules and except as so affirmed, reverses the aforesaid Bankruptcy Court determination of September 28, 1979 which permitted compensation to be paid to and retained by Israel & Raley for professional services rendered to Futuronics Corporation; and it is further

ORDERED, ADJUDGED AND DECREED that Futuronics Corporation shall recover from Israel & Raley the costs of this appeal as more fully set forth in the Bill of Costs.

Dated: New York, New York
August 29, 1980

/s/ Kevin Thomas Dutty

KEVIN THOMAS DUFFY
U.S.D.J.

APPENDIX D

LAW OFFICES OF FRED ISRAEL
1015 18th Street, N.W.
Washington, D.C. 20036

Fred Israel
Charles E. Raley

202-2906-1580

January 30, 1975

Gary B. Sachs, Esquire
Arutt Nachamie & Benjamin
11 West 42nd Street
New York, New York 10036

Re: Futuronics Corporation, Freeport, Long Island
New York, Retainer and Fee Agreement

Dear Gary:

Enclosed is Mr. Israel's Affidavit pertaining to our retainer and fee agreement for submission in Arrangement Proceedings No. 75 B 11 in the United States District Court for the Southern District of New York.

You will note that the enclosed Affidavit recites the following agreement:

1. The rate for services performed by Mr. Israel is $100.00 per hour and $85.00 per hour for associate's time.

2. A retainer of $7,500.00 will be paid to the Law Offices of Fred Israel from first available funds and $7,500.00 from next available funds.

3. An advance against out-of-pocket expenses in the amount of $2,500.00 will be paid to the Law Offices of Fred Israel from first available funds.

4. In addition to the payment of all out-of-pocket expenses and the foregoing retainer, the Law Offices of Fred

Israel will be paid fees for professional services rendered, according to the following schedule:

a. Contract No. F34601-70-C-3556,
U.S. Air Force, Sacramento, California:

One-third of all progress payments released and paid to Futuronics – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments to Futuronics.

b. Contract No. M00027-69-C-0045,
U.S. Marine Corps:

One-third of all funds recovered by or contract adjustments to Futuronics.

c. Contract No. DAAB05-71-C-3703,
U.S. Army, ECOM:

One-third of all funds recovered by or contract adjustments to Futuronics.

d. Contract No. DAAB07-74-C-0327,
U.S. Army, ECOM:

Contract No. DAAB07-70-C-4417,
U.S. Army, ECOM:

Contract No. DAAB05-73-C-1002,
U.S. Army, ECOM:

Contract No. DAABO5-74-C-1300,
U.S. Army, ECOM;

Contract No. F19628-74-C-0119,
U.S. Air Force, Hanscom Field;

and

all other Contracts between Futuronics and the United States Government:

One-third of all Progress payments released and paid to Futuronics – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments to Futuronics.

5. The Law Offices of Fred Israel will pay the law firm of Arutt, Nachamie & Benjamin, one-third of all fees received for professional legal services and assistance agreed to be rendered by the law firm of Arutt, Nachamie & Benjamin to the Law Offices of Fred Israel in relation to the contract claims of Futuronics against the United States Government.

Also enclosed is a copy of this letter with spaces provided for the signature of Mr. Blanck and for the signature of a partner of your firm. If the foregoing retainer and fee agreements are acceptable to Futuronics and your firm, please have the enclosed copy fully executed and dated and return it to us. We understand that such execution is possible only after the Court has approved the retainer and fee agreement.

Very truly yours,

/s/*Charles E. Raley*
Charles E. Raley

APPROVED and ACCEPTED:

_____ Date: _____
Albert A. Blanck
President, Futuronics Corp.

_____ Date: _____
Partner
Arutt, Nachamie & Partner Benjamin

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter

of

FUTURONICS CORPORATION
Debtor.

In Proceedings for an Arrangement
No. 75 B 11

DISTRICT OF COLUMBIA, ss:

AFFIDAVIT

FRED ISRAEL of the law firm of Law Offices of Fred Israel, 1015 18th Street, N.W., Washington, D.C., being duly sworn, deposes and says:

1. That he has been a member of the Bar of the District of Columbia continuously since 1964.

2. That he has been intimately involved with contracts of the Department of Defense ("DOD"), and, more specifically, contracts for electronic equipments.

3. That the matters involved in his retention by the Debtor deal primarily with DOD contracts.

4. That he has had considerable experience before the Armed Services Board of Contract Appeals and the United States Court of Claims.

5. That the claims of the Debtor against he United States Government and potential counterclaims and/or set-offs by the United States Government against the Debtor will require the services of a person, or persons, familiar with Federal Government Administration and Litigation and who possess the necessary experience.

6. That the hourly rate for legal services performed by his firm is $100.00 per hour for Mr. Israel and $85.00 per hour for associate's time.

7. That a retainer of $7,500.00 will be paid to the Law Offices of Fred Israel from first available funds and $7,500.00 from next available funds.

8. That an advance against out-of-pocket expenses in the amount of $2,500.00 will be paid to the Law Offices of Fred Israel from first available funds.

9. That in addition to the payment of all out-of-pocket expenses and the foregoing retainer, the Law Offices of Fred Israel will be paid fees for professional servicios rendered, according to the following schedule:

a. Contract No. F34601-70-C-3556,
U.S. Air Force, Sacramento, California:
One-third of all progress payments released and paid to Debtor – hourly rate against 20%, which is greater, of all other funds recovered by or contract adjustments to Debtor.

b. Contract No. M00027-69-C-0045,
U.S. Marine Corps.
One-third of all funds recovered by or contract adjustments to Debtor.

c. Contract No. DAAB05-71-C-3703,
U.S. Army, ECOM:
One-third of all funds recovered by or contract adjustments to Debtor.

d. Contract No. DAAB07-74-C-0377,
U.S. Army, ECOM:

Contract No. DAAB07-70-C-4417,
U.S. Army, ECOM:

Contract No. DAAB05-73-C-1002,
U.S. Army, ECOM;

Contract No. DAAB05-74-C-1300
U.S. Army, ECOM;

Contract No. F19628-74-C-0119,
U.S. Air Force, Hanscom Field;

and

all other Contracts between Debtor and the United States Government:

One-third of all Progress Payments released and paid to Debtor-hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments to Debtor.

10. That the law firm of Arutt, Nachamie & Benjamin ("ANB") have agreed to render legal services and assistance to the Law Offices of Fred Israel in connection with the administration, litigation and/or resolution of the problems arising from the Debtor's contracts with the United States Government. Based on the services agreed to be rendered by ANB, we have agreed to distribute fees received by us on a basis of two-thirds to ourselves and one-third to ANB.

/s/ Fred Israel
Fred Israel

LAW OFFICES OF
FRED ISRAEL
1015 18th Street, N.W.
Washington, D.C. 20036
(202) 296-1580

Subscribed and sworn to before me this 4th day of February, 1975.

/s/ Beverly M. Byrd
Beverly M. Byrd, Notary Public

My Commission expires: 10/14/76

APPENDIX E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter	:
of	:
FUTURONICS CORPORATION,	:
Debtor.	:

TO THE HONORABLE ASA S. HERZOG, BANKRUPTCY JUDGE:

FUTURONICS CORPORATION, by its attorneys, ARUTT, NACHAMIE & BENJAMIN, respectfully alleges, as follows:

1. That it is the Debtor-in-Possession herein, acting as such and operating and managing its business and affairs pursuant to an Order of this Court.

2. The bulk of Applicant's business is done by way of contract with various of the governmental agencies, for example: U.S. Air Force, U.S. Marine Corps, U.S. Army.

3. The work performed by Applicant on behalf of these governmental agencies is to develop certain electronic systems on an experimental and production basis, the nature of which is hichly technical and in some areas secret.

4. Bulk of Applicant's difficulties arose when the Government stopped the progress payments, and as a result, Applicant's cash flow ceased and it was not able to continue functioning.

5. Applicant requires the services of an attorney who specializes in dealing with the Government administrative agencies, more particularly with contracts of the Department of Defense, the Armed Services Board of Contract Appeals, and the U.S. Court of Claims.

6. It is respectfully submitted that Mr. Israel has expertise in these fields, and we are advised that he has sufficient Government clearances to deal with the so-called "secret" materials.

7. Applicant desires to retain Mr. Israel in accord with the affidavit sworn to by him on March 3, 1975.

WHEREFORE, Applicant respectfully requests the within order, for all of which no prior application has been made.

Date: New York, New York
March 7, 1975

FUTURONICS CORPORATION
BY: ARUTT, NACHAMIE & BENJAMIN
Attorney for Debtor

By: */s/ Gary B. Sachs*

Gary B. Sachs, an associate
of the firm
Office & P.O. Address
11 West 42nd Street
New York, New York 10036

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter	In Proceedings for an Arrangement
of	No. 75 B 11
FUTURONICS CORPORATION, Debtor.	

CITY OF WASHINGTON)
) ss:
DISTRICT OF COLUMBIA)

AFFIDAVIT

FRED ISRAEL of the law firm of Law Offices of Fred Israel, 1015 18th Street, N.W., Washington, D.C., being duly sworn, deposes and says:

1. That he has been a member of the Bar of the District of Columbia continuously since 1964.

2. That he has been intimately involved with contracts of the Department of Defense ("DOD"), and more specifically, contracts for electronic equipments.

3. That the matters involved in his retention by the Debtor deal primarily with DOD contracts.

4. That he has had considerable experience before the Armed Services Board of Contract Appeals and the United States Court of Claims.

5. That the claims of the Debtor against the United States Government and potential counterclaims and/or set-offs by the United States Government against the Debtor will require the services of a person, or persons, familiar with Federal Government Administration and Litigation and who possess the necesary experience.

sons, familiar with Federal Government Administration and Litigation and who possess the necessary experience.

6. That the hourly rate for legal services performed by his firm is $100.00 per hour for Mr. Israel and $85.00 per hour for associate's time.

7. That a retainer of $7,500.00 will be paid to the Law Offices of Fred Israel from first available funds and $7,500.00 from next available funds.

8. That an advance against out-of-pocket expenses in the amount of $2,500.00 will be paid to the Law Offices of Fred Israel from first available funds.

9. That in addition to the payment of all out-of-pocket expenses and the foregoing retainer, the Law Offices of Fred Israel will be paid fees for professional servies rendered, according to the following schedule:

a. Contract No. F34601-70-C-3556,
U.S. Air Force, Sacramento, California:

One-third of all progress payments released and paid to Debtor – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Debtor.

b. Contract No. M00027-69-C-0045,
U.S. Marine Corps:

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Debtor

c. Contract No. DAAB05-71-C-3703,
U.S. Army, ECOM:

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Debtor.

d. Contract No. DAAB07-74-C-0327,
U.S. Army, ECOM:

Contract No. DAAB07-70-C-4417,
U.S. Army, ECOM:

Contract No. DAAB05-73-C-1002,
U.S. Army, ECOM;

Contract No. DAABO5-74-C-1300,
U.S. Army, ECOM;

Contract No. F19628-74-C-0119,
U.S. Air Force, Hanscom Field;

and

all other Contracts between Debtor and the United States Government:

One-third of all Progress Payments released and paid to Debtor – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Debtor.

/s/ Fred Israel

Fred Israel

LAW OFFICES OF FRED ISRAEL
1015 18th Street, N.W.
Washington, D.C. 20036
(202) 296-1580

Subscribed and sworn to before lme this 3rd day of March, 1975.

/s/ Beverly M. Bird

Beverly M. Bird, Notary Public

My Commission Expires: 10/14/76

APPENDIX F

ARUTT. NACHAMIE & BENJAMIN
ATTORNEYS
11 WEST 42ND STREET
NEW YORK, N.Y. 10036
WISCONSIN 7-6630

Samuel A. Arutt
Barton Nachamie
Charlotte P. Arutt
Abel Jack Schwartz
William S. Kaye

A. Michael Fox
Gary B. Sachs

Max Nachamie (1930-61)
Irving Benjamin (1930-59)
Jay H. Siskin (1933-69)
Isaac Knox (retired)

March 31, 1975

Fred Israel, Esqs.
1015 18th Street
Washington, D.C. 20036

RE: FUTURONICS CORPORATION

Dear Mr. Israel:

Enclosed please find a conformed copy of the order authorizing your firm's retention. It has been recently brought to my attention that your mother died and please accept the firm's condolences.

Very truly yours,

ARUTT, NACHAMIE & BANJAMIN

BY: */s/ Gary B. Sachs*
GARY B. SACHS

GBS/rs
encl.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of FUTURONICS CORPORATION, Debtor.	In Proceedings for an Arrangement No. 75B11 ORDER AUTHORIZING RETENTION OF ATTORNEY FILED Mar. 11, 1975

UPON reading and filing the annexed application of FUTURONICS CORPORATION, by its attorneys. ARUTT, NACHAMIE & BENJAMIN, and no adverse interests being represented, it is

ORDERED, that FUTURONICS CORPORATION be and it hereby is authorized to retain the firm of FRED ISRAEL for the purpose set forth in the affidavit of Mr. Israel, which is annexed hereto and made part hereof. Compensation of Mr. Israel shall be in accord with Paragrphs 8 and 9 of Mr. Israel's affidavit.

Dated: New York, New York
Mar. 10 1975.

/s/ Asa S. Herzog
Bankruptcy Judge

APPENDIX G

ARUTT. NACHAMIE & BENJAMIN
ATTORNEYS
II WEST 42ND STREET
NEW YORK, N.Y. 10036
WISCONSIN 7-6630

Samuel A. Arutt
Barton Nachamie
Charlotte P. Arutt
Abel Jack Schwartz
William S. Kaye

A. Michael Fox
Gary B. Sachs

Max Nachamie (1930-61)
Irving Benjamin (1930-59)
Jay H. Siskin (1933-69)
Isaac Knox (retired)

April 8, 1975

Fred Israel, Esq.
1015 18th Street
Washington, D.C. 20036

RE: FUTURONICS CORPORATION

Dear Mr. Israel:

Enclosed herewith please find the retainer letter signed by all parties involved.

Very truly yours,

ARUTT, NACHAMIE & BANJAMIN

BY: */s/ Gary B. Sachs*
GARY B. SACHS

GBS/rs
encl.

LAW OFFICES OF FRED ISRAEL
1015 18th STREET N.W.
WASHINGTON, D.C. 20036

Fred Israel
Charles E. Raley

202 296-1580

March 3, 1975

Gary Sachs, Esquire
Arutt, Nachamie & Benjamin
11 West 42nd Street
New York, New York 10036

Re: Futuronics Corporation

Dear Gary:

Enclosed is my affidavit pertaining to our retainer and fee agreement for submission in Arrangement Proceedings No. 75 B 11 in the United States District Court for the Southern District of New York.

This affidavit replaces the affidavit previously sent to you and removes Paragraph 10 from that affidavit.

In view of the fact that we will be looking to your law firm for legal services and assistance in connection with the matters we are undertaking under the agreement, and may be working through your firm with the creditors to try to effect an agreement with the United States, I would suggest that you prepare appropriate billings for your time and at the conclusion of this matter, we could go to the Court and recommend to them how the fees are to be distributed. Please provide us with copies of your time records.

Your will note that the enclosed Affidavit recites the following agreement:

1. The rate for services performed by Mr. Israel is $100.00 per hour and $85.00 per hour for associate's time.

2. A retainer of $7,500.00 will be paid to the Law Offices of Fred Israel from first available funds and $7,500.00 from next available funds.

3. An advance against out-of-pocket expenses in the amount of $2,500.00 will be paid to the Law Offices of Fred Israel from first available funds.

4. In addition to the payment of all out-of-pocket expenses and the foregoing retainer, the Law Offices of Fred Israel will be paid fees for professional services rendered, according to the following schedule:

a. Contract No. F34601-70-C-3556,
U.S. Air Force, Sacramento, California:

One-third of all progress payments released and paid to Futuronics – hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Futuronics.

b. Contract No. M00027-69-C-0045,
U.S. Marine Corps:

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Futuronics.

c. Contract No. DAAB05-71-C-3703,
U.S. Army ECOM;

One-third of all funds recovered by or contract adjustments or any other increases in contract price to Futuronics.

d. Contract No. DAAB07-74-C-0327,
U.S. Army, ECOM;

Contract No. DAAB07-70-C-4417,
U.S. Army, ECOM;

Contract No. DAAB05-73-C-1002,
U.S. Army, ECOM;

Contract No. DAABO5-74-C-1300,
U.S. Army, ECOM;

Contract No. F19628-74-C-0119,
U.S. Air Force, Hanscom Field;

and

All other Contracts between Futuronics and the United States Government:

One-third of all Progress Payments released and paid to Futuronics—hourly rate against 20%, whichever is greater, of all other funds recovered by or contract adjustments or any other increases in contract price to Futuronics.

Also enclosed is a copy of this letter with spaces provided for the signature of Mr. Blanck and for the signature of a partner of your firm. If the foregoing retainer and fee agreements are acceptable to Futuronics and your firm, please have the enclosed copy fully executed and dated and

return it to us. We understand that such execution is possible only after the Court has approved the retainer and fee agreement.

Very truly yours,

/s/ Charles E. Raley
Charles E. Raley

Enclosures

APPROVED and ACCEPTED:

/s/ *Albert A. Blanck* Date: 4/4/75
Albert A. Blanck
President, Futuronics Corp.

/s/ *Samuel A. Arutt* Date:3/21/75
Samuel A. Arutt, Partner
Arutt, Nachamie & Benjamin

APPENDIX H

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of –	)
	)
Futuronics Corporation,	)
Debtor-in-Possession	)
	)
Under Contracts Nos.	) ASBCA Nos.
DAAB05-71-C-3703	) 20760
M00027-69-C-0045	) 19520
F34601-70-C-3556	) 19977, 20625, 21460
F19628-74-C-0119	) 19978, 21191
DAAB05-70-C-4417	) 20141
DAAB05-74-C-1300	) 20140
DAAB05-73-C-1002	) 20137
N00126-74-C-0015	) 20708
N00126-74-C-0010	) 20709
DAAB07-74-C-0327	) 20136
DAAB07-74-C-0546	) 20139
DAAB05-74-C-3435	) 20138
DSA900-75-C-1230	) 20227
DSA900-74-C-4334	) 20026
DSA900-74-C-8768	) 20027, 20606
DAAB05-70-C-4121	) 17960
DAAB05-70-C-4123	) 17960
DAAB05-68-C-0627	) 18268
DSA900-75-M-S896	) 21200

APPEARANCES FOR THE APPELLANT:

Charles E. Raley, Esq.
Fred Israel, Esq.
Israel and Raley
Washington, D.C.

APPEARANCES FOR THE GOVERNMENT:

Colonel Joseph A. Dudzik, Jr., JAGC
Chief Trial Attorney
Lt. Colonel James F. Price, JAGC
Captain Roy D. Carlton, JAGC
Trial Attorneys

Colonel John T. Murphy, USAF
Chief Trial Attorney
Edward Constable, Esq.
Captain Paul Meador, USAF
Trial Attorneys

Patrick J. Gnazzo, Esq.
Navy Chief Trial Attorney
Martha A. Klein, Esq.
Trial Attorneys
A. Kevin Fahey, Esq.
Assistant Counsel
Headquarters, U.S. Marine Corps

Charles J. Roedersheimer, Esq.
Trial Attorney
Defense Electronics Supply Center (DLA)

OPINION BY ADMINISTRATIVE JUDGE VASIL S. VASILOFF

By letter dated 17 January 1979 counsel for appellant submitted to the Board an executed stipulated settlement agreement pursuant to which the parties have settled all claims and disputes under the above-captioned appeals. Under the agreement the parties have stipulated the following.

> Appeal No. 20760 was filed on October 29, 1975, from a failure of the Contracting Officer to render a final decision under firm fixed-price supply Contract DAAB05-71-C-3703 for the manufacture and delivery of AN/GRC-106 radio sets and items ancillary thereto, which had been awarded to Appellant on October 21, 1970, by the U.S. Army; and was ended on August 10, 1973. The Appeal alleged economic duress in the ending of the subject Contract. Also, on November 10, 1976, Appellant filed a breach of contract action against the Government on Contract DAAB05-71-C-3703 in the United States Court of Claims.
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> Appeal No. 19520 was timely filed from a termination of fixed price supply Contract No. M00027-69-C-0045 for default on June 26, 1974. The subject Contract was awarded by the U.S. Marine Corps on September 30, 1968, for the manufacture and delivery of Electronic Shops and items ancillary thereto. The Appeal challenged the default and also alleged economic duress in a Contract modification in June, 1972.
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> Appeal Nos. 19977 and 20625 were timely filed from a suspension of progress payments in December, 1974, and a termination of fixed price, supply Contract No. F34601-70-C-3556

for default on August 7, 1975. The subject Contract was awarded by the U.S. Air Force on June 29, 1970, for the manufacture and delivery of Mobile Data Terminals, spare parts, and items ancillary thereto.

Appeal Nos. 19978 and 21191 were timely filed from a suspension of progress payments in December, 1974, and a termination of fixed price supply Contract No. F19628-74-C-0119 for default on April 27, 1976. The subject Contract was awarded by the U.S. Air Force on May 7, 1974, for the manufacture and delivery of Test Sets and items ancillary thereto.

Appeal No. 20141 was timely filed from a termination of fixed price supply Contract No. DAAB05-70-C-4417 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on April 28, 1970, for the manufacture and delivery of Modems and items ancillary thereto.

Appeal No. 20140 was timely filed from a termination of fixed price supply Contract No. DAAB05-74-C-1300 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on September 12, 1973, for the manufacture and delivery of Modems and items ancillary thereto.

Appeal No. 20137 was timely filed from a termination of fixed price supply Contract No. DAAB05-73-C-1002 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on September 20, 1972, for the manufacture and delivery of Flight Coordination Centrals and items ancillary thereto.

Appeal No. 20708 was timely filed from a termination of fixed price supply Contract No. N00126-74-C-0015 for default on September 4, 1975. The subject Contract was awarded by the U.S. Navy on September 30, 1973, for the manufacture and delivery of Intercomunication Stations and items ancillary thereto.

Appeal No. 20709 was timely filed from a termination of fixed price supply Contract No. N00126-74-C-0010 for default on September 4, 1975. The subject Contract was awarded by the U.S. Navy on July 25, 1973, for the manufacture and delivery of Intercommunication Stations and items ancillary thereto.

Appeal No. 20136 was timely filed from a termination of fixed price supply Contract No. DAAB07-74-C-0327 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on April 8, 1974, for the manufacture and delivery of Shelters and items ancillary thereto.

Appeal No. 20139 was timely filed from a termination of fixed price supply Contract No. DAAB07-74-C-0546 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on June 27, 1974, for the manufacture and delivery of Receiver Audio, BFO, and VR Module Assemblies, and items ancillary thereto.

Appeal No. 20138 was timely filed from a termination of fixed price supply Contract No. DAAB05-74-C-3435 for default on February 21, 1975. The subject Contract was awarded by the U.S. Army on September 21, 1973, for the manufacture and delivery of Oscillator Oven Assemblies and items ancillary thereto.

Appeal No. 20227 was timely filed from a termination of fixed price supply Contract No. DSA900-75-C-1230 on March 11, 1975. The subject Contract was awarded by the Defense Electronics Supply Center on October 3, 1974, for the manufacture and delivery of Loop Battery Modules.

Appeal No. 20026 was timely filed from a termination of fixed price supply Contract No. DSA900-74-C-4334 for default on December 11, 1974. The subject Contract was awarded by the Defense Electronics Supply Center on January 25, 1974, for the supply of Loudspeakers.

Appeal Nos. 20027 and 20606 were timely filed from a termination of fixed price supply Contract No. DSA900-74-C-8768 for default on December 17, 1974, and from a resulting assessment of excess reprocurement costs. The subject Contract was awarded by the Defense Electronics Supply Center on May 8, 1974, for the manufacture and delivery of Loudspeakers.

Appeal No. 17960 was timely filed from a termination of fixed price supply Contract Nos. DAAB05-70-C-4121 and DAAB05-70-C-4123 on November 1, 1972. The subject Contracts were awarded by the U.S. Army on June 22, 1970, and June 26, 1970, respectively, for the manufacture and delivery of Teletypewriters and items ancillary thereto.

Appeal No. 18268 was timely filed under fixed price supply Contract No. DAAB05-68-C-0627 for the reimbursement of amounts paid for the use of Government-furnished property which was allegedly not used in fact. The subject

Contract was awarded by the U.S. Army on June 25, 1968, for the manufacture and delivery of Teletypewriters.

At all times during the periods of the foregoing Contracts, Appellant was a small business concern. On January 3, 1975, Appellant became Futuronics Corporation Debtor-In-Possession by operation of Chapter XI of the Bankruptcy Statutes of the United States, Title 11 of the United States Code.

After preliminary discovery in some of the individual Appeals and as a result of a series of Prehearing Conferences, by an Order of the Board the subject Appeals were consolidated into one proceeding for trial and resolution of all subsidiary issues as well as the ultimate issue of whether the Government caused the Appellant's bankruptcy. Trial Counsel for the Air Force and the Army were designated as lead counsel for the Government.

As a part of this Consolidation, the parties engaged in extensive discovery until August, 1977, at which time, Appellant was to file a Statement of Facts on all Appeals together with supporting documentary evidence and tenders of testimony and, thereafter, the Government was to file its own Statement of Facts with documents and tenders in response to the Appellant's Statement and the Hearing would then commence. In August, 1977, Appellant filed its Statement, consisting of eighteen (18) volumes of factual statements and fifty-two (52) volumes of documents indexed to each factual statement. In October 1977, the Government similarly filed an eighteen (18) volume Statement and volumes of documents in response to Appellant's Statement.

As a result of the taking of depositions by both parties, the hearing did not commence until 6 June 1978. The hearing proceeded with the appellant's case until 13 September 1978 at which time the Board requested that the parties investigate the possibility of discussing a settlement and report to the Board. The parties agreed to participate in settlement discussions with Administrative Judge V.S. Vasiloff participating and 4 October 1978 was set as the date for the beginning of such discussions.

Prior to the start of the hearing, the parties had met on four separate occasions to discuss settlement without success. On 4 October 1978 settlement discussions commenced with Administrative Judge Vasiloff present and participating. The discussions continued into 5 October 1978 and an agreement was reached on the afternoon of 5 October 1978.

The settlement agreement reached by the parties is as follows:

1.a. Appellant shall be paid the amount of Four Million Six Hundred Fifty Thousand Dollars ($4,650,000.00) by a United States Treasury Check or Checks delivered to and made payable to Futuronics Corporation Debtor-In-Possession within ten (10) days after the submission of an invoice by Futuronics after the entry of the Order and execution of the Contract modification under Para. No. 6, infra. As hereinafter provided the Government will, in addition, assume responsibility for direct settlement and payment of all vendor/subcontractor cancellation charges arising out of the above-captioned prime contracts.

1.b. Ten Per Cent (10%) of the said payment of $4,650,000.00 (i.e., the amount of $465,000.00) shall be deposited in a separate interest bearing account chosen by Futuronics under the direction of the Bankruptcy Court and such separate account shall not be disbursed for a period of twelve (12) months or upon the completion of all subcontractor and/or vendor settlements, whichever shall first occur, and disbursement shall be upon application to the Bankruptcy Court after notice to the Termination Contracting Officer. This fund is to be deposited for the purpose of serving to expedite the actions to be taken with respect to the vendor and/or subcontractor settlements under the terms of this agreement.

2. Immediately upon the execution of the Contract modification, Futuronics shall transfer title and deliver to the Government in the manner and to the extent directed by the Termination Contracting Officer all prime Contract inventory presently in Futuronics' possession or control under paragraph (b)(vi) of the clause entitled 'Termination for the Convenience of the Government,' ASPR Section 7-103.21 or its equivalent in each of the subject Contracts, with payment by the Government to Futuronics for all actions related to the disposition of such property as provided in ASPR Section 8. Solely with respect to the subcontractor and/or vendor claims under the above-captioned Contracts, except Contract DAAB05-68-C-0627, which was completed, each of the prime Contracts shall be treated as if Terminated for the Convenience of the Government under ASPR Section 7-103.21, or its equivalent in each of the subject Contracts, as of the date

each Contract ended, as stated above. The negotiation , settlement, and payment of the subcontractor and/or vendor claims will be accomplished by the TCO in accordance with the provisions of ASPR Section 8, subject to the liability definitions in Para. 3, *infra.*, with monthly payments to Futuronics for services as directed and approved by the TCO in connection with the subcontractor and/or vendor settlements.

3. The Government's liability on the vendor and/or subcontractor claims is limited to those charges not recorded on Futuronics' books and records as of the date each prime Contract ended and which are allowable under Section 8 of ASPR. Subject to this limitation, the Government will save Futuronics harmless from such charges. Conversely, Futuronics will save the Government harmless from any and all subcontractor and/or vendor claims which exceed the Government's liability as stated herein.

4. Upon conclusion of each subcontractor and/or vendor settlement, the Government and, as necessary, Futuronics shall execute with the subcontractor or vendor a written release and discharge of both the Government and Futuronics, and shall furnish a true copy thereof to Futuronics.

5. Futuronics will retain all books, records, documents, and other materials relating to the above-captioned Contracts and all subcontracts and orders thereunder as provided by the Termination for Convenience Clause.

6. The complete execution of this agreement, including the contract modification issued pur-

suant hereto, is contingent upon the entry of a final order, approving the foregoing settlement terms, by the United States District Court of the Southern District of New York in Proceedings for an Arrangement No. 75B11. It is recognized that the Parties' undertaking hereunder will be subject to the continuing jurisdiction of said Court.

7. By execution of the Court-approved contract modification issued pursuant hereto, Futuronics, without exception, and the Government, within the authority of the Contracting Officer, shall release and discharge in accord and satisfaction any and all claims each against the other wherever filed or, as yet, unfiled arising out of or resulting from any of the above-captioned contracts or any other contract between the parries as of the date of this Opinion, including, but not limited to the Government's Claims 193 and 248, as filed in Appellant's Bankruptcy, totalling $8,658,376.05. Upon issuance of said contract modification, the Appellant shall file formal notices with the Armed Services Board of Contract Appeals and the United States Court of Claims securing the dismissal of all pending actions therein, with prejudice.

8. There shall be one composite modification incorporating the terms hereof issued by the Government and executed by an authorized Contracting Officer. The said modification shall be issued to Futuronics on or before January 20, 1979, and the modification shall be executed by Futuronics within three (3) days after the entry of a Court Order confirming the settlement agreement in total.

In accordance with the terms of the parties' stipulation, which the Board hereby adopts as its findings of fact and conclusion of law, the above-captioned appeals are SUSTAINED to the extent, manner, and amounts set forth in the stipulation.

Dated 19 January 1979.

/s/ Vasil S. Vasiloff
VASIL S. VASILOFF
Administrative Judge
Member of Division No. 8
Armed Services Board of
Contract Appeals

I Concur

/s/ John J. Grossbaum
JOHN J. GROSSBAUM
Administrative Judge
Member of Division No. 8
Armed Services Board of
Contract Appeals

I concur

/s/ Richard C. Solibakke
RICHARD C. SOLIBAKKE
Administrative Judge
Chairman, Armed Services
Board of Contract Appeals

I concur

/s/ Daniel M. Arons
DANIEL M. ARONS
Administrative Judge
Vice Chairman, Armed Service
Board of Contract Appeals

I certify that the foregoing is a true copy of the opinion and decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 20760, 19520, 19977, 20625, 21460, 19978, 21191, 20141, 20140, 20137, 20708, 20709, 20136, 20139, 20138, 20227, 20026, 20027, 20606, 17960, 18268 and 21200, Appeals of Futuronics Corporation, Debtor-in-Possesion, rendered in conformance with the Board's Charter.

Dated: 26 Jan 1979

/s/ George L. Hawkes
GEORGE L. HAWKES,
Recorder
Armed Services Board of
Contract Appeals

APPENDIX I

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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In the Matter

of

FUTURONICS CORPORATION,

Debtor.

ORDER APPROVING COMPROMISE AND SETTLEMENT OF THE CLAIMS AND LITIGATION WITH THE UNITED STATES OF AMERICA

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Upon the order of this Court, dated the 1st day of February, 1979, and the application of the debtor and debtor in possession ("Futuronics") for an order approving the stipulated opinion of compromise and settlement of a) claims filed by the United States of America (the "Government") claiming priority under Section 64(a)(5) of the Bankrupty Act, b) claims asserted by Futuronics against the Government in litigation pending before the Armed Services Board of Contract Appeals, c) claims of certain vendor and subcontractor creditors described more fully in the said application and papers annexed thereto; the stipulated opinion ("Settlement Opinion") of Administrative Judge Vasil S. Vasiloff of the Armed Services Board of Contract Appeals, dated the 19th day of January, 1979, (Exhibit A annexed) requiring approval of the settlement terms by this Court; and creditors and the Creditors' Committee having been given notice in the form annexed hereto by publication and by mail of the proposed compromise and settlement and that the rights of certain vendors and subcontractors to Futuronics may be affected; and the Government hav-

and that the rights of certain vendors and subcontractors to Futuronics may be affected; and the Government having assumed liability for payment of claims of those vendor and subcontractor creditors described in the annexed settlement opinion and notice to creditors; and upon the hearing held before the undersigned on the 16th day of February, 1979; and upon all the papers and proceedings had herein; and the compromise and settlement appearing to be in the best interests of the creditors of Futuronics and the estate, it is

NOW, on motion of Finley, Kumble, Wagner, Heine & Underberg, attorneys for Futuronics,

ORDERED, that the settlement terms and conditions set forth in the annexed stipulations and opinion of Judge Vasily S. Vasiloff, dated January 19, 1979, (Exhibit A) are approved and confirmed in all respects, and it is further

ORDERED, that Debtor be and it hereby is authorized to execute any and all documents, papers and instruments, including a contract modification in accordance with the terms and conditions set forth in Exhibit A, and to execute any and all other documents, papers and instruments necessary to implement and effectuate the terms and conditions of the settlement, and it is further

ORDERED, that the Government shall pay to Futuronics (the "Payment") the amount of Four Million, Six Hundred Fifty Thousand ($4,650,000) Dollars by a U.S. Treasury check or checks made payable to Futuronics Corporation, Debtor in Possession, within ten (10) days after entry of this order provided that Futuronics shall have first executed a contract modification incorporating the terms of the settlement, and it is further

ORDERED, that pursuant to the provisions of Paragraph 1.b. of Exhibit A, ten (10%) percent of the payment ($465,000) shall be either deposited in an interest-

bearing account or utilized for the purchase of an interest bearing certificate of deposit at a bank which is a designated depository of this Court, with such sum not to be disbursed for a period of twelve (12) months unless sooner permitted pursuant to the provisions of Paragraph 1.b. of the settlement opinion upon application to this Court, on notice to the Government Termination Contract Officer, and it is further

ORDERED, that the balance of the said payment shall be deposited by Futuronics in one or more interest-bearing accounts or utilized to purchase one or more certificates of deposit as may be appropriate in a designated depository or depositories of this Court, with such funds, not to be withdrawn except on further application and order of this Court; upon notice to counsel for the creditors committee/MBDC, subject to accounting and monthly reports to this Court, and it is further

ORDERED, that pursuant to the terms of the annexed settlement herein approved, the Government shall assume sole liability and responsibility for payment of all vendor and subcontractor claims and charges against Futuronics arising out of cancellation of the Futuronics prime contracts described in Exhibit A for all charges commencing with the date each contract ended, with the Government's liability limited to those charges not recorded on Futuronics' books and records as of the date each prime contract ended. Payment to such claimants shall be made directly by the Government in accordance with the "Termination for the Convenience of the Government" settlement procedures under Armed Services Procurement Regulations (ASPR) and the said vendor/subcontrator claimants are required to file their claims with the Government Termination Contracting Officer within 90 days after receiving written notice to be served by Futuronics upon each of said claimants together with forms for the requisite submission of claims to the Termination Contract

Officer and a further notice that submission of such vendor/subcontractor claims under "Termination for the Convenience of the Government" procedures shall be claimant's exclusive remedy against Futuronics. Vendor/subcontractor creditors affected by the foregoing procedures are those whose claims arise out of termination of the following contracts:

DAAB05-71-C-3703
M00027-69-C-0045
F34601-70-C-3556
F19628-74-C-0119
DAABO5-70-C-4417
DAAB05-74-C-1300
DAAB05-73-C-1002
N00126-74-C-0015
N00126-74-C-0010
DAAB07-74-C-0327
DAAB97-74-C-0546
DAAB05-74-C-3435
DSA900-75-C-1230
DSA900-74-C-4334
DSA900-74-C-8768
DAAB05-70-C-4121 & 4123,

and it is further

ORDERED, that conditioned upon execution by Futuronics of the requisite contract modification, the Government priority claims filed in these proceedings (Nos. 193 and 248) totalling $8,658,376.05 shall be expunged, and it is further

ORDERED, that the claims or portions of claims heretofore or hereafter filed in these proceedings which are subject to the "Termination for the Convenience of the Government" procedures shall be expunged by order of this Court on application of Futuronics upon ten (10) days notice to the creditor affected.

Dated: New York, New York
February 16, 1979

/s/ Stanley T. Lesser
BANKRUPTCY JUDGE